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Brief of Willard for Respons

511

Filed Nov. 26, 1897.

IN THE

Supreme Court of the United States,

OCTOBER TERM, A. D. 1897.

HARRY W. DICKERMAN, TRUSTEE, ET AL.,
Petitioners,

vs.

THE NORTHERN TRUST COMPANY AND OVID B. JAMESON, TRUSTEES, AND COLUMBIA STRAW PAPER COMPANY,
Respondents.

Petition of Harry W. Dickerman, Trustee, et al., for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITION.

CHARLES A. DUPEE

AND

MONROE L. WILLARD,

SOLICITORS FOR RESPONDENTS.

HARNARD & MILLER PRINT, CHICAGO.

IN THE

Supreme Court of the United States.

OCTOBER TERM, A. D. 1897.

HARRY W. DICKERMAN, TRUSTEE, ET AL., *Petitioners*, *vs.* THE NORTHERN TRUST COMPANY AND OVID B. JAMESON, TRUSTEES, AND COLUMBIA STRAW PAPER COMPANY, *Respondents*.	**Petition of Harry W. Dickerman, Trustee, et al., for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.**

BRIEF FOR RESPONDENTS,

The Northern Trust Company and Ovid B. Jameson, Trustees, in Opposition to Petition and Brief contained therein.

The decision of the Circuit Court of Appeals, Seventh Circuit, in this case, is upon page 700 of the record. It is reported in Vol. 80 Fed. Rep., 450. It affirmed the decision of the Circuit Court, reported in Vol. 75 Fed. Rep., 936. (Record p. 681)

The facts are so fully stated by the Court of Appeals in its decision as to necessitate but a brief statement here.

The bill was filed to foreclose a trust deed in the nature of a mortgage executed by the defendant Columbia Straw Paper Company to complainants as trustees to secure 1,000 bonds, each for $1,000. The defendant

company answered, admitting all the substantial allegations of the bill. These petitioners owned a small minority of stock in the defendant company, and as such stockholders obtained leave to become parties defendant and to answer the original bill, also to file a cross-bill. They filed their answer, charging fraud and collusion on the part of the company and its controlling stockholders in an over-valuation of the properties conveyed to the company, for which its bonds and most of its stock were issued. Their answer insisted that by means of such over-valuation the bondholders and others acquired stock of the company without sufficient return therefor; that a liability arose on the part of the bondholders to the company to pay for the stock acquired by them, and they insisted that the court in that proceeding should determine the amount of such over-valuation and liability and set off such liability against the bonds. Petitioners owned 1,855 shares of the 40,000 shares of the company's stock.

The facts and details are fully stated in the opinion of the Court of Appeals. (Rec., 697–700.)

Complainant's position in regard to such answer was that there had been no fraud or collusion, no fraudulent over-valuation, and no over-valuation at all; that all parties, including the petitioners, or their assignors, were parties to and participated in the transaction by which the defendant company acquired its properties; that everything done had been done in entire good faith, and that there had been no concealment or misrepresentation; that every bondholder had paid *par* for his bond, and that all the charges of the answer were groundless.

Next, that had there been an over-valuation, this

would be immaterial, unless such over-valuation were fraudulent, and that such was not the fact in this case.

"It is now well settled that in order to invalidate an issue of stock which is issued for property taken at an over-valuation, it must be shown not only that there was an over-valuation, but also that such over-valuation was intentional and consequently fraudulent.

"The property is not to be considered as over-valued merely because, subsequently, it turns out to be so. The various circumstances under which the valuation was made should be considered in determining the *bona fides* of the transaction."

1 Cook on Stockholders, Sec. 35.

2 Thompson on Corporation, Sec. 16–18, and cases cited.

Coit v. *Gold Amalgamating Co.*, 119 U. S., 343, 7 Sup. Ct. R., 232.

Gamble v. *Queen's Co. Water Co.*, 25 N. E. R., 201.

Young v. *Erie Iron Co.*, 31 N. W. R., 814.

Bickley v. *Schlag*, 20 Atl. R., 250.

Next, that even if there had been a fraudulent over-valuation, in such a proceeding as this by the corporation, or by stockholders on its behalf, there would be no stock liability. This is on the principle that, while courts can enforce contracts as made, and while they may, in proper cases, rescind contracts, they cannot make contracts for a man or hold him upon a contract which he never made.

"The corporation itself, after issuing its stock as paid-up stock, and declaring it so to be, cannot subsequently repudiate that declaration and agreement and proceed to collect, either from the person receiving the stock or his transferee, the unpaid

part of the par value. It is estopped from so doing.

Where, however, actual fraud enters into the transaction, then the corporation is not estopped from having the agreement set aside. The person receiving the stock can then be compelled to return the stock or its market value and take back that which he gave to the corporation for it; but the corporation cannot hold him liable for the par value of the stock."

1 Cook on Stockholders, Sec. 38.

"Stockholders in a corporation, who participate or aid in the issue of paid-up stock, upon payment of less than its par value, or who have knowledge of the fact and acquiesce therein, can not afterwards complain of the transaction, either in their own behalf or in behalf of the corporation. They are bound by estoppel or acquiescence."

1 Cook on Stockholders, Sec. 39.

Brant v. *Ehlen*, 59 Md., 1.

In the above case JUSTICE WOOD, delivering the opinion of the court, said:

"The stock held by the defendant was evidenced by certificates of full paid shares. It is conceded to be the contract between him and the company that he should never be called upon to pay any further assessments upon it. The same contract was made with all the other shareholders, and the fact was known to all. As between them and the company this was a perfectly valid agreement. It was not forbidden by the charter or by any law of public policy, and as between the company and the stockholders was just as binding as if it had been expressly authorized by the charter. If the company, for the purpose of increasing its business, had called upon the stockholders to pay up that part of their stock which had been satisfied 'by discount,' according to their contract, they could have successfully resisted such a demand. No action could have been main-

tained by the company to collect the unpaid stock for such a purpose. The shares were issued as full paid on a fair understanding, and they bound the company."

Phelan v. *Hazard*, 5 Dillon, 45–52.

In the above case Judge DILLON, in giving the opinion of the court, referring to cases where it was claimed that stock had been issued by the company for property of less value than the par value of the stock, said:

"The proof showed that the shares in question had been paid for precisely as they were originally agreed to be paid for, viz.: by a conveyance of the mining property to the corporation. This conveyance had been received and recorded by the corporation. Unless this agreement is rescinded or set aside for fraud, how can it be said that the stock has not been paid for? The parties have agreed that it has been paid for, and that agreement is conclusive, unless it is rescinded or impeached for fraud; and this can not be done unless the attack is directly made.

"The authorities establish that such a transaction is not *ultra vires* and absolutely void; second, that the contract is valid and binding upon the corporation and the original share-takers, unless it is rescinded and set aside for fraud, and that where the contract stands unimpeached, the court *even where the rights of creditors are involved*, will treat that as a payment which the parties have agreed shall be payment."

Corporations cannot rescind without restoring that which has been received.

2 Thompson on Corporations, Sec. 1635.

Even in case of a fraudulent over-valuation, the company has no equity except to rescind by a proper return of the land; where this has become impossible it cannot rescind.

DuPont v. *Tilden*, 43 Fed. R., 87.

In this case the contract between Stein and the company was fully executed. By it the stock company got $200,000 and 39 mills, and Stein got the stock and bonds. This was the only contract between the parties. There was no stock subscription. Either that contract was valid and binding, which was the end of the matter, or was voidable. In the latter case, it might be promptly rescinded in a proper proceeding. If rescinded, the contract relations with the parties are ended. Each must return to the other what it received. If enforced, it must be enforced as made. Neither party can substitute another contract in the place of that actually made. Stein, or his grantees, could not be held to pay for the stock, as he never contracted to pay for it, except in the way shown in his contract.

It was further contended that these petitioners assented to the transaction whereby the bonds and stock of the corporation were conveyed for its properties, and were in no position to question the transaction.

The law is fully settled that where all the stock and all the bonds of a corporation are conveyed for property which the company acquires, all *then* stockholders assenting, neither the company nor any *then* or subsequent stockholders can complain.

Scofield v. *Thayer*, 105 U. S., 143.
Bank of Ft. Madison v. *Alden*, 129 U. S., 372 (9 Sup. Ct. R., 332).
Memphis R. R. v. *Dow*, 120 U. S., 287 (7 Sup. Ct. R., 482).
Higgins v. *Lansingh*, 154 Ill., 333.
Stuart v. *St. L. R. R.*, 41 Fed. R., 736.
St. L. R. R. v. *Tiernan*, 37 Kas., 606 (15 Pac. R., 544).
Peoria R. R. v. *Thompson*, 103 Ill., 187.

Finally, it was contended that even were there an enforcible stock liability, such liability could not be enforced in this proceeding; that the defendant, being a corporation organized under the laws of New Jersey, stockholders could be liable only under the laws of that State in a proceeding had therein, and that in this proceeding, to which no creditor, and but a part of the stockholders were parties, the court could not grant the relief nor sustain the defense asserted by the answer

The Circuit Court found that there was no evidence of fraud or of fraudulent overvaluation, or of any overvaluation at all; that there had been no misrepresentation or concealment; that the transaction by which the stock and bonds were turned over by the company in return for the properties which it acquired was known to all concerned, and that these petitioners participated in the transaction, and received in connection with it a part of the stock, and that every bondholder had paid in full for his bond. The Court of Appeals concurred in all these conclusions. The court in its opinion says (Rec., 700):

> "Upon a careful perusal of the record and testimony, we find no error in the conclusions of law or fact, and think that the decree of the Circuit Court should be affirmed. The defendants seemed to have failed wholly in making good the allegations contained in the answer.
>
> "The principal questions discussed and on which the case turned in the court below, seemed to be: whether there was any fraud or collusion practiced in the organization of the company and the issuing of the stock; whether stock was issued without consideration and which has not been paid for; whether there had been a fraudulent overvaluation of the property and different mill plants conveyed to the defendant company under the options taken

by Stein, and if so, whether those defendants who are the appellants here, being simply stockholders in, and not creditors of, the company, were in a position to urge such matters in defense to defeat the foreclosure of the mortgage or deed of trust given by the company to the trustees to secure the one million dollars of bonds on sale of which the money was raised to put the new enterprise upon its feet. The main question is whether there is any liability on the part of the stockholders in defendant company which can be enforced in this proceeding, or set up as a reason for defeating the foreclosure. We are of opinion that these contentions made by the defendants were properly overruled. *The prime difficulty was in the lack of evidence to support the allegations of the answer. There was no evidence of any fraudulent overvaluation or of issuing stock without consideration.*"

A petition for rehearing presented and argued was denied. (Rec., 732.)

This finding of the lower courts, that in the transaction there was no evidence whatever of fraud or overvaluation renders it unnecessary to consider whether the other positions of complainants would have been a sufficient answer to the claims contained in the answer of petitioners.

I.

The main contention of petitioners is under heading "III" (pp. 12–18 of petition), that the Court of Appeals erred in determining that there was *no* evidence to support the allegations of the answer of defendant stockholders.

Will this court grant the petition, in order to review the conclusion of the Court of Appeals upon the question of fact, where the unanimous court found the facts

as the Master in Chancery and as the Circuit Court had already found them, especially when, had the finding been different, petitioners would not have been entitled in that proceeding to the relief they sought?

Is this finding, which is so entirely just under the evidence, such a question of gravity and importance as to lead this court to require the cause to be certified to this court ?

We shall not venture to trespass upon the indulgence of the court, by stating in detail the evidence, which abundantly justified the action of the court, (and which is scattered through the record and summed up by the Court of Appeals), or by a discussion of the facts involved.

II.

Petitioners are not entitled to prosecute their petition so far as the same relates to questions of procedure in the trial court.

It is settled that in a bill to foreclose a mortgage or trust deed, stockholders are not necessary parties, and they are allowed to become parties by leave of court only when some fraudulent conduct on the part of the bondholders, trustees, or other parties, is alleged to have occurred which could affect the rights of the trustees to foreclosure proceedings.

Thomas v. *Railroad*, 109 U. S., 526.

The court let in petitioners, who were minority stockholders, to establish, if they could, the charges of fraud averred in their answer, which, if proved, might prevent foreclosure or create a right of set-off on the part of the company against the bonds representing the mort-

gage indebtedness. They then, and for that purpose, became entitled to be heard upon all questions involved, whether of procedure or otherwise. It was determined by the court that they had wholly failed to establish the necessary facts to support their answer, and hence were entitled to no relief. They were then, *ipso facto* set outside the case and became strangers to it, and it stands as it would had they never been permitted to intervene—as a case between the trustees and the defendant company, whose action, in the absence of fraud, binds all stockholders, including petitioners. The defendant company is satisfied, and does not seek to escape the decree. It did not prosecute an appeal to the Court of Appeals, nor does it join in this petition.

We contend, then, that whether the bonds should have been produced before the decree was entered; whether undue haste was exhibited by the trustees in taking possession under the Flanagan judgment; or what else was done in the case, are matters about which these petitioners have no right to be heard, that they are not entitled to prosecute this petition in regard thereto, and that the case stands between the complainants and the defendant company exactly as it would had petitioners never been permitted to intervene, and their first appearance in the case was to present this petition.

III.

Petitioners contend that the bonds should have been produced before decree of foreclosure and sale.

First, this proposition is one which, as we have shown, petitioners have no right to urge here. Only the company which represented petitioners and other stockholders, in a manner satisfactory to itself, could do so.

Secondly, whether they should have been produced or not is not a question of such gravity and importance as to cause this court to grant this petition.

Finally, the court did not err in not requiring the production of the bonds before such decree.

The opinion of the Court of Appeals (Rec., 703) fully covers the question: The court says:

> "Another contention made and decided in the court below was that the bonds should have been produced before the Master. It was alleged in the original bill that 'all of the 1,000 bonds of $1,000 each, with the coupons attached, were duly issued, negotiated and sold, and are now outstanding and valid obligations of the defendant Columbia Straw Paper Company, and the same, with the coupons annexed thereto, have come into the possession of, and are now held by, a large number of persons who have become the owners thereof;' and this was admitted by the defendant company in their answer. The testimony for complainants shows that the bonds described in the mortgage were certified and issued by the defendant company; that the company had not paid any of them; that the interest coupons due January 1, 1895, have not been paid. The Master found that all the issue of said 1,000 bonds was negotiated and sold, and is now outstanding and is a valid obligation of the defendant company, and that they were due and unpaid.

The court also so found, and ordered a sale unless payment was made within a specified time. The trustees were not the owners of the bonds, or any part of them, but they were *mortgagees in possession*, and had power under the trust deed to enforce the lien by foreclosure and sale. In these cases where bonds issued by railroads, or other large corporations, on a large scale, and held in trust by trustees, but really owned by persons in many parts of the civilized world, it has not been the practice, nor would it be practicable, to require the bonds to be produced before the court or Master before a decree *nisi* is entered. The practice has uniformly been to enter a decree of sale without the production of the bonds. Of course, they cannot be paid or share in the proceeds of sale until brought into court for payment and cancellation. In many cases years elapse after a decree is entered before all the bonds are brought in, the money lying in the registry of the court awaiting their presentation for payment, and in some cases all the bonds are never produced or paid. If the rule required all the bonds to be produced before the court or Master before a decree for sale could be made, it would, in many cases, be a partial denial of justice. No such practice has ever obtained to our knowledge. The sale is made for the benefit of all propperly concerned. The decree is not final as to the persons or debts entitled to share in the proceeds. When the time for distribution arrives any creditor may challenge the title of the claimant of any bond presented. The course of proceeding in such case is properly indicated in *Taber* (*Toler*) v. *E. Tenn. R. R.*, 67 Fed. Rep., 168, *Guaranty Safe & Deposit Co.* v. *Green Cove Springs*, 139 U. S., 150."

When it was established that all the bonds had been issued and were still outstanding and wholly unpaid; that none of them were held by complainant trustees, but by a large and widely scattered body of persons who had become their owners, and that they were negotiable and

their ownership might be changed before a sale, no useful object could have been attained by their production before a decree; while to require such production would have resulted in a practical denial of justice to many holders of the bonds. The cases cited for petitioners are cases where the defendant insisted on the production of the note, or where plaintiff had attempted to establish a debt in the absence of the defendant without such production.

And it appears from those cases that where, as in this case, the amount of the indebtedness was admitted, the production of the note was not essential.

Counsel conceded in their petition for rehearing that had there been an admission of the indebtedness the production of the bonds would have been unnecessary. (Rec., 714.) Here it was admitted that the bonds were outstanding obligations of the defendant company. It was proved that they were due, and this proof could be and was conclusively made without the production of the bonds.

IV.

Petitioners urge (p. 10) that undue haste was made in obtaining the Flanagan judgment, and on the part of the trustees in taking possession of the property.

We reply as before, that petitioners are in no position to urge this point; that the question is not one of gravity and importance, and that there is no evidence of collusion or fraud in regard thereto, and that the parties did only what they had a legal and moral right to do.

V.

Petitioners urge (p. 21) that the Circuit Court should have allowed their answer to be amended in order to show that the organization of the defendant company and the execution of the bonds and mortgage were parts of a scheme to form a "trust," or unlawful combination in restraint of trade.

Again, we say that petitioners, who were admitted to the case only for a special purpose, which they failed to establish, are in no position to urge this point.

Next, that the question does not, under the evidence in the record, present a question of gravity or importance, and that there was no error on the part of the Circuit Court in refusing leave to amend.

The answer of appellants was, by leave of court, filed May 18, 1895. (Rec., 106.) October 10, 1895, the issues were referred to the master to take proofs and report. (Rec., 263.) The court ordered that proofs for complainants be closed in twenty days, which would be October 30th, and for defendants, within thirty days thereafter. Appellees' proofs were concluded October 25th. (Rec., 292.) The time for defendants to close proofs expired November 30th. It was, on their motion, extended to December 19th, and later to December 30th. (Rec., 293.) Afterwards it was further extended to January 6th, when the time expired, and the court refused to further enlarge it. (Rec., 325.) It appears from the record (p. 316) that on February 9, 1896, after the time in which to take testimony was closed, appellants filed, without leave of court, their amended answer; also, that on March 4, 1896, a motion for leave to

file amended answer was denied. (Rec., 325.) As the amended answer, so filed without leave, set up the "trust" question, it must be presumed, as was the fact, that this is the answer that appellants desired to file.

It was too late after the proofs were closed, for parties to come in and make a new defense to be set up by amended answer, and the court acted correctly in refusing such permission. Seeking at such time to make such new defense was an attempt to trifle with the court and disregard its orders.

Moreover, the court, upon the petition of Miller, had already done what petitioners say it could do of its own motion. It had investigated the trust question.

Miller's petition was filed January 10, 1896. (Rec., 295.) The petition set out, with great particularity, the trust theory. (Rec., 295–305.) The petition itself, various affidavits and all the evidence in the case were before the court.

Several days were consumed upon the argument, in reading the testimony and citing the decisions applicable. The court then took the case under advisement. (Rec., 314, 315, 324, 325.) Finally, on March 4, 1896, it denied the petition (Rec., 325), holding that there was no "trust." It was bad faith for appellants to delay until February 9th, thirty days after the proofs were closed, before making an application for leave to make such amendment.

Neither upon the final hearing, nor before the Court of Appeals, was this trust question presented or argued, and for this reason the opinion of the Court of Appeals, as well as that of the Circuit Court, does not refer to the question, it having been abandoned

It is plain that no trust was involved.

The Federal Act, relating solely to interstate commerce, has no application here.

U. S. v. E. C. Knight Co., 156 U. S., 1.

The New Jersey laws authorize a company to purchase and hold real estate in New Jersey or elsewhere, such as its business may require. There were seventy similar companies doing business in the United States of which this company acquired thirty-nine—but little more than half in number or in capacity for manufacturing. A monopoly *could not* be created by it. There is no evidence that the company ever designed to or did create a monopoly.

> "A voluntary dissolution of all competing companies and the formation of a single corporation under the statutes of some state, the new corporation becoming the purchaser of all the properties of the antecedent corporations, and the shareholders in such corporations receiving shares in the new corporation, upon the basis agreed upon in the scheme of re-incorporation, is not an illegal act."

5 Thompson's Commentaries, Law of Corporations, Sec. 6,400–1.

Oakdale Mfg. Co. v. Gast, 28 Atl. Rep., 973.

Were it necessary to go further, it appears from the record that appellants were participators in the alleged illegal acts; that the stock certificates they held and on which they had any standing in court were attended with any illegalities that affected the bonds and mortgage. They were parts of the same alleged illegal trust or combination. Appellants were prime actors in the scheme as shown by the options they executed. They were *in pari delicto* with the parties whom they attacked.

It is elementary that courts will give no relief of any kind to parties to an illegal transaction.

> 1 Pomeroy's Eq. Jur., Sec. 397, 401, 2nd Ed.
>
> *Dent* v. *Ferguson*, 132 U. S., 50; 10 Supr. R., 13.

VI.

Finally, petitioners urge (p. 22, *et seq.*) that the Court of Appeals erred in sustaining the action of the Circuit Court in striking their cross-bill from the files.

Again, we represent that petitioners are not qualified to raise this question; that it is not a matter of gravity and importance whether the court struck this cross-bill from the files, and that there was no error therein.

In this case the defendant stockholders (petitioners) came in to file answer and cross-bill, not under any original right, but solely by permission of court.

The Court of Appeals says (80 Fed. R., 456):

> "The answer to this objection is that the appellants were not made defendants, and only came in and were allowed to intervene by permission and order of court. The cross-bill was not an original proceeding on their part. Stockholders are not necessary parties in a bill against the corporation to foreclose a trust deed. They are only allowed to come in, under leave of the court, where fraud on the part of the bondholders, trustees or other parties has occurred which would affect the right of the trustees to foreclose. (*Thomas* v. *Railroad Co.*, 109 U. S., 526; 3 Sup. Ct., 315.) Appellants were not creditors, and constituted but a very small part of the stockholders. The court, upon petition, permitted them to become defendants and put in an answer and cross-bill upon the supposition that their

answer might show a state of facts which would defeat or qualify the right of foreclosure. The substance of their answer was, as before stated, that the bondholders had acquired their stock without paying for it, and were indebted to the company for it, and that there was a fraudulent overvaluation of the property. The answer was filed on May 18, 1895, and the cross-bill on the same day. The matters set up in the cross-bill were the same, being substantially identical in averment and phraseology with those set up in the answer, and were clearly matters of defense. There was, therefore, no need of a cross-bill, and to file such a one was an abuse of the leave given by the court. For these reasons the court was amply justified in withdrawing its permission and striking the cross-bill from the files. This practice is recognized and fully sustained in *Forbes* v. *Railroad Co.*, 2 Woods, 323; Fed. Cas., No. 4,926. In regard to cross-bills which are filed under permission, that permission presupposes that the matter of the cross-bill will be germane to the original bill, and such as could not be set up by answer. And if when the cross-bill is filed it appears to violate all these rules, and to be an abuse of the leave granted by the court, the court will withdraw the permission and dismiss the cross-bill, instead of putting the complainant to his demurrer. This practice seems to be entirely rational and just, and such as a court of equity will approve. The cross-bill was not germane to the original bill, which was simply to foreclose a mortgage. It alleged a fraudulent over-valuation of property by the company and by directors and stockholders; that the contract under which the bonds were issued was fraudulent and void; and that the bonds and mortgage were void, all of which was matter of defense, and had been set up in the answer. It also alleged a liability on the part of the bondholders, or some of them, as stockholders, which, if it existed at all, could only be enforced at the instance of creditors, in a suit to which all stockholders were parties. This was not germane to a bill to

foreclose a mortgage. If two answers setting up the same matter had been put in, no one would question that one of them should be struck out, and the labeling of one as a cross-bill does not change the rule. A cross-bill, being an auxiliary bill merely, must be a bill touching matters in question in the original bill. If its purpose is different from that of the original bill it is not a cross-bill, even though the matters presented in it have a connection with the same general subject (*Crosse* v. *De Valle*, 1 Wall., 1); and a cross-bill setting up no defense except what could be set up by answer will be dismissed (*Investment Corp.* v. *Marquam*, 62 Fed., 960)."

It would seem that nothing need be added.

The interlocutory orders of a court are always under its control. The permission which a court has given, it may, for good cause, revoke. If it finds that a party whom it has let into the cause is, under pretense of seeking affirmative relief, setting up what is merely matter of defense, it may revoke its original order allowing the cross-bill to be filed, or, since it amounts to the same thing, may strike the cross-bill from the files.

Here, since the petitioners were able to furnish no evidence to support the allegations of their answer, there was the same inability to support the same allegations in the cross-bill, and they have sustained no injury by the order of court.

The entire case of petitioners was wholly destitute of merit. In a suit by trustees to foreclose a mortgage against the defendant company, they sought as stockholders to show that, in connection with the execution of the mortgage and the bonds secured thereby, there had been a fraudulent overvaluation of the property which had been conveyed to the company for its stocks

and bonds—a transaction to which they were parties. They insisted that by reason of such fraud a stockholder's liability arose to pay the unpaid part of the stock; that in this proceeding, to which no creditor and but a part of the stockholders were parties, the court should ascertain the extent of the overvaluation, make an assessment upon the stock, and set off such assessment against such bondholders as happened to own stock. There were many reasons why this was impossible which it is not necessary now to state. As petitioners utterly failed to establish the foundation fact of their case, that there was any fraud of any kind, they are entitled to no further assistance, and it is submitted that no useful purpose can be subserved by granting their petition.

Respectfully submitted.

Charles A. Dupee and
Monroe L. Willard,
Solicitors for Respondents.

No. 33.

Brief of Willard for Respt.

Filed Feb. 13, 1899.

Supreme Court of the United States.

OCTOBER TERM, A. D. 1898.

Case No. 16,724. Term No. 196.

HARRY W. DICKERMAN, Trustee of Second National Bank of Rockford, Illinois, F. J. DIEM, E. P. HOOKER, Trustee for the Merchants National Bank of Defiance, Ohio, Trustee and in his own behalf and JAMES C. RICHARDSON,
Petitioners,

vs.

THE NORTHERN TRUST COMPANY and OVID B. JAMESON, Trustees,
Respondents.

AMENDED BRIEF FOR RESPONDENTS.

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LOUIS MARSHALL,

Solicitors for Respondents.

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Petitioners,

vs.

THE NORTHERN TRUST COMPANY and OVID B. JAMESON, Trustees,

Respondents.

BRIEF FOR RESPONDENTS.

STATEMENT OF THE CASE.

This proceeding was a bill (Rec., 3), brought by The Northern Trust Company, a corporation organized under the laws of Illinois, and doing business at Chicago, and Ovid B. Jameson, a citizen of the State of Indiana, as trustees, against the Columbia Straw Paper Company, a corporation organized under the laws of New Jersey, to foreclose a trust deed covering thirty-nine paper mill plants, given by the Columbia Straw Paper Company to the appellees to secure the payment of one thousand

(1,000) bonds of the company each for the sum of $1,-000, payable to the bearer or registered owner thereof in gold coin and bearing interest at six per cent. per annum from December 1, 1892, payable half-yearly, the interest on the bonds being secured by coupons in the usual manner attached to the bonds.

The bill alleges (Rec., 14), and the proof showed (Rec., 219), that on December 1, 1893, said company made default in redeeming or discharging the one hundred bonds which, by the terms of the bond and mortgage, were to be paid and redeemed on said date by payment therefor of the sum of $110,000 and accrued interest; that on December 1, 1894, said company made default by failing to redeem or discharge the one hundred and five bonds or any part thereof, which, by the terms of the bond and mortgage, were to be paid and redeemed on said day; that said company further made default on December 1, 1893, and on December 1, 1894, by failing on each of said dates to pay into the sinking fund referred to in the mortgage the sum of $110,000, together with interest on such bonds as had been redeemed December 1, 1893; that said company on June 1, 1894, made default in payment of the interest which on that day became due on each of said entire issue of bonds, and on December 1, 1894, said company made default in the payment of interest which at that day became due and payable on said entire issue of bonds.

The bill also alleged and the proof showed that the trust deed should become enforcible if an execution should be sued out against any of the property of the company; and thereupon the trustee should declare the principal and interest owing on the bonds to be immediately payable (Rec., 30); that on January 22, 1895, (Rec., 224)

an execution was sued out against the property of said company upon a judgment obtained against it by James Flannagan, before George W. Underwood, a justice of the peace in Cook County, Illinois, and that said company had failed to remove, discharge or pay such execution; that by reason thereof the trustees had declared the principal and interest owing upon said entire issue of bonds to be immediately due and payable (Rec., 220), that the said Columbia Straw Paper Company was insolvent, and that complainant had taken possession of all the mortgaged property.

At the commencement the Columbia Straw Paper Company was the only defendant. It filed its answer (Rec., 70), admitting all the substantial allegations of the bill. During the progress of the case, appellants, minority stockholders of said company, upon petition (Rec., 74), were allowed to come in and answer and to file a cross-bill. Their answers were filed (Rec., 86), setting up collusion and fraud on the part of the company, and some of its stockholders, especially in over-valuing the various mill plants and properties upon which options of purchase had been taken, and which were transferred to the company in exchange for its bonds and capital stock. The said Columbia Straw Paper Company having been organized for the purpose of taking such conveyances, and thus consolidating said mill plants, defendant's contention was that in consequence of said fraudulent over-valuation, a defense in the nature of set-off existed in favor of the company against such bondholders as were also stockholders to the extent of the unpaid part of the stock held by them. They also filed a cross-bill (Rec., 123), which was mainly a verbatim copy of their answer. The court afterwards struck the cross-bill from the files. (Rec.,

256.) This act of the court appellants claim was erroneous. Later they amended their answer (Rec., 316) alleging that the bonds and mortgage were part of an illegal seheme to create a monopoly, regulate prices and prevent competition. The amended answer alleged that there were seventy mills engaged in the manufacture of wrapping paper, *all in competition with each other;* that the Columbia Straw Paper Company obtained control of forty of the mills and operated but sixteen. Appellants afterwards sought leave to further amend their answer. As no showing was made as to the contents of such proposed amendment, or as to any necessity therefor, the court denied the motion. (Rec., 264.)

The cause was referred to the Master in Chancery to take proofs and report upon all the testimony taken in the case. He reported (Rec., 265) April 15, 1896, that the material allegations of the bill were sustained by the proof ; that all of the issue of bonds was sold and was outstanding and was a valid obligation of the company, and that the indebtedness of the company upon the bonds was $1,249,632.86 ; that the contention of the defendants that the stock of the company which passed into the hands of Emanuel Stein was unpaid, was not supported by the evidence ; that said stock was received by said Stein in fulfillment of his contract with the company as fully paid stock, and that, as a matter of law, any question in regard to the liability of stockholders of the company could not be inquired into in this proceeding. He also found that the contention of the defendants, that the procurement of the Flannagan judgment was the result of collusion with the company, was not supported by the testimony, and that there were no creditors of the company except those represented in this proceeding.

Defendant stockholders filed exceptions (Rec., 508) to the report. On hearing the exceptions were overruled, and decree of sale *nisi* was entered in favor of complainants (Rec., 525). On appeal to the Circuit Court of Appeals for the Seventh Circuit, that court affirmed the decree. (Rec., 571; 80 Fed. R., 450.)

In 1890, there were in the territory west of Pittsburg, east of Lincoln, Nebraska, south of Minneapolis, and north of the Ohio river, upwards of sixty mills engaged in the manufacture of wrapping paper from straw. (Rec., 339.) The business, as it had been carried on by the separate mills, each with a full set of officers and managers and with inadequate capital, had not been profitable. In 1890, an attempt had been made to consolidate these mills or part of them. The purpose of the scheme was to obtain sufficient capital, to reduce expenses by a consolidation of the various interests and by the organization of a single management. John B. Sherwood and E. G. Church undertook, at one time, to secure capital and to form a corporation for the purpose. They obtained options of purchase from a considerable number of mill owners. (Rec., 142.) The scheme for some reason fell through. In February, 1892, Emanuel Stein and the said Church commenced investigating said mill properties and business with a like end in view. At the same time, James C. Richardson and Fred C. Trebein were attempting a similar plan on behalf of mill owners, but their scheme, as an independent plan, failed of accompllshment.

Stein soon after met Sherwood, who had considerable knowledge as to the value of mills, cost of production, and probable profits, and Sherwood thereafter aided Stein

in procuring options and in the formation of plans. About the same time Stein sought the advice and assistance of millmen and dealers in straw paper and, of such parties, especially associated with himself, John B. Halladay, Fred C. Trebein, Church and Sherwood. These persons set about investigating the value of mills, the prices at which they could be purchased, and arranging for a corporation which should acquire them. Through their efforts Philo D. Beard and Thomas D. Ramsdell of Buffalo, also became associated with them in the enterprise. Finding it necessary to employ legal counsel in the formation and development of their plans, as well as to procure financial assistance, they employed the firm of Guggenheimer & Untermyer, of New York City, as persons who had had a large experience as advisors and assistants in the promotion and formation of industrial enterprises. Stein and his associates, after investigating the prices at which the mills could be bought, determining what mills would be useful and necessary, investigating their respective outputs, etc., arranged to procure option contracts from the owners of thirty-nine mill plants, situated in eight different states and twenty-eight different counties. Such options were to run to December 31, 1892. Between February and December, 1892 (Rec., 454, *et seq.*), there were many meetings between the persons named and the respective mill owners who were to come into the enterprise. At these meetings the terms of the option contracts and all the details of the scheme were substantially arranged. The option contracts were prepared by the legal counsel. They were executed by the respective mill owners to Beard and Ramsdell, and their assigns. The option contracts bore different dates extending over a number of months. They were alike except in dates,

amounts and names of vendors. The preambles of the option contracts (Rec., 503) were that the vendor mill owners owned certain mill properties and were engaged in the production of straw paper, that they desired to sell to a corporation to be organized by the second parties; that the latter had offered to organize such corporation, provided they could secure options of purchase; that the second parties proposed to organize one or more corporations with a share capital of one million dollars of preferred stock, three million dollars of common stock, and with a bonded debt of one million dollars, secured by a mortgage or trust deed on the property of the company.

By section one the vendor corporation granted to the second parties an option of purchase until December 31, 1892, by them or their nominees, or assigns, or a corporation to be organized by them, of absolute title to the property described.

In section two, the vendors made a like grant of their stock and agreed, if their options were accepted, to deposit the stock in *escrow*.

In section three, there was a like agreement as to title deeds, etc.

In section four, the second parties agreed if they accepted the options, they would pay for the properties a specified sum of money and a specified amount of common and of preferred stock in such company as they might organize as soon thereafter as should be practicable.

In section five, the second parties agreed in case of acceptance of options to organize a corporation to be known as the Columbia Straw Paper Company, which

should have a share capital of one million dollars preferred stock, and three million dollars common stock, and should have power to bond and mortgage its property for one million dollars.

In section six, the directors of the vendor company agreed to act as the directors in the new company if they should be so requested.

In section seven the vendors granted their good-will.

Section eight states that it is understood that the second parties, their nominees or assigns, are "to procure options from certain persons and firms and from other corporations engaged in the manufacture of straw paper, with a view of transferring the options so to be obtained by them, or of accepting such options and the properties referred to therein, and subsequently transferring title to the corporation."

Section nine provided that the bonds and stock of the company to be organized, might be issued in part payment of all properties to be acquired under the options.

Section ten declared that when the second parties *at their own cost and expense*, should have organized such company, the title deeds, etc., which had been placed in *escrow*, should be delivered to the end that the corporation to be formed be vested with the title to the property. If the company purchased directly it was to pass resolutions authorizing the purchase, and agreeing to pay the cash and allot the bonds provided for to the vendor company.

Section eleven declared that a list of the properties was attached.

The above form of contract was to be used when the grantor was a corporation. Other printed forms were

used when the vendors were individuals or partnerships. Only such changes were made as were rendered necessary by such facts. There was no provision in the contracts as to the number of plants upon which options should be procured, and which the company should ultimately acquire. This evidently was left to be governed by circumstances as they should develop or for a future agreement.

Although the second parties were by the terms of the contract to organize a new corporation at their own expense, although they were to obtain the options and do all necessary work preliminary thereto, examine and perfect titles, procure and record conveyances, expend money on the employment of agents and attorneys, give their own services for an indefinite term, and do all necessary work preliminary to promoting the company and discharge all the expenses thereof, and this without any possibility of reward from the company or any one in case the scheme should fail prior to its complete execution, no provision, in terms, was made for their compensation or reimbursement. Appellees contend that it was the intention of the parties that all the stocks and bonds of the company, except so far as the same were specifically appropriated by the contracts, should be for promotion expenses. Appellants' claim is that all this labor and expense was to be rendered gratuitously.

The parties of the second part to the options were Philo D. Beard and Thomas B. Ramsdell of Buffalo. Ramsdell soon abandoned the enterprise, and transferred his interests in the contracts to Emanuel Stein of Chicago. Beard also at a later date assigned his interest to Stein, but for what consideration the evidence does not disclose. Stein accepted the options, acquired title to the

properties and organized the Columbia Straw Paper Company. In pursuance of the plan, he made a proposition (Rec., 401) to the company for a sale to it of the properties described in the option contracts attached to his proposition. The proposition was, with some modifications, accepted by the company, and on October 15, 1892, he entered into an agreement with the company (Rec., 404) by the terms of which he agreed to acquire a good title to all of the property mentioned in the option contracts, and to convey the same to the company, and also to furnish the company $250,000 in cash. In return the company agreed, in consideration of the foregoing to turn over to him the stock and bonds of the company. This contract was executed by the parties by the transfer of the property and money to the company and the delivery of the stock and bonds to Stein. This was the only contract which was made with regard to the company's stock, except as to eighteen shares taken by the board of directors prior to the above contract. There was in the transactions nothing in the nature of an ordinary stock subscription. The transactions between the company and Stein were shown on the records of the company. On January 28, 1893, the foregoing contract was modified by a further agreement between Stein and the company. (Rec., 495.)

All the stock of the company, other than what remained in Stein's hands, was afterwards acquired by the subsequent holders either from Stein or his transferees.

There was no agreement between Stein and the mill-owners, or other parties in interest, either in the option contracts or elsewhere, that he should procure options

on or convey to the company more than the thirty-nine mills which were transferred to the company.

John B. Sherwood, one of the promoters of the company, who testified on behalf of defendant stockholders (appellants), and who held $25,000 of stock which he had obtained from Stein for services in procuring options, stated (Rec., 341) that it was agreed and was the understanding that options should be taken on all the mills. On cross-examination (Rec., 367 to 371) he said that these statements were made to him by Stein, Church, Trebein and Halladay. But, being pressed, he was wholly unable to testify that either of these persons so stated to him, but did say that it was *his own* understanding that seventy mills were to be taken in, and that in his conversation with Stein and others organizing the company, he talked about seventy mills, and they never said to him otherwise than that the seventy mills were to go in. That was the extent of his evidence on that subject, and there was no evidence to support him.

February 8th, about a month after the foreclosure suit was commenced, Sherwood addressed to Stein the following letter, and addressed similar letters to the other directors of the company (Rec., 145–375):

> "INDIANAPOLIS, February 8, 1895.
>
> "DEAR SIR: I expect you, Mr. .... and the others engaged in the formation and management of the Columbia Straw Paper Company, from whom I received twenty-five thousand dollars in the stock of said company for information given and services rendered, to jointly make said stock good to me. I shall give you until February 21st, next, to consult and make arrangements for the payment. If, at the end of that time, I do not hear favorably on the proposition, I shall communicate with the different stockholders and creditors

and submit a plan to them of enforcing a stock liability, existing over one million dollars, growing out of the manner of the formation of the company, by which means a substantial value will be given to all the stock of the company and the unsecured indebtedness liquidated in full.

I assure you that the method of the organization of the company will be brought to light in a court of equity, and the liability fixed, notwithstanding the manner in which the records of the company have been made to read, for I am familiar with the whole proceeding. A receiver will then act for the creditors and stockholders, as well as for the bondholders, and all the parties will be held to be holders of their stock by original subscription on the facts found.

Very truly yours,

JOHN B. SHERWOOD."

He testified (Rec., 374):

"I think it was in March, 1895, possibly as early as February, 1895, when I found, to protect my interests as a stockholder, a fight had to be made on the mortgage. I immediately took steps necessary to make a fight. I refer to the present fight. (Rec., 375.) I am partly in it; I promoted it, induced it, and brought it about. (Rec., 377.) Had the men to whom I addressed the letter come down with twenty-five thousand dollars, and made my stock good, I should not have picked out my men and got them together."

The affidavit in support of the petition of appellants to become parties was by John B. Sherwood; the petition was verified by the oath of Sherwood alone (Rec., 84); the answer of the defendant stockholders to the original bill was signed by Sherwood as agent for said respondents (Rec., 99); the cross-bill of said respondents was verified by said Sherwood alone (Rec., 116); *no mill owner or vendor in the option contracts was called as a*

witness by or on behalf of appellants, or appeared to testify in the case. And no stockholder other than Sherwood testified to any facts which would tend to show that anything done by Stein, or by the company, did not have the full sanction of every mill owner and stockholder. No one of the appellants supported the allegations of the answer by his testimony or by any affidavit. Appellants derived their stock from Stein. They are all either mill owners, vendors under the option contracts, or they have received their stock from such vendors. Appellees contend that appellants are the mere tools and pawns of Sherwood, who has prosecuted this proceeding for the purpose of extorting money.

Dickerman, Trustee, one of appellants, has in all (Rec., 101), 400 shares of preferred and 400 shares of the common stock of the company. He acquired it from Freeman Graham, Jr., and Julius Graham, who were the owners of the paper mill at Rockford, Illinois, and who executed to Stein the option therefor, for $160,000, payable $53,000 in cash, $53,000 in preferred stock, and $106,700 in common stock, in all $212,700. The sum of $52,700, being the difference between the selling price named in the contract and the amount called for by the contract, and being about one-third the selling price, was in excess of the agreed value of the property, and was a *bonus*, or gift of stock, or an agreed share of the enhanced value of the consolidated property above its prime cost from the mill-owners.

Diem, another of appellants, is the owner (Rec., 101) of 110 shares of preferred and 120 shares of common stock of the company. This stock is a part of what he received from Stein in payment of his mill at Dayton, Ohio. The option price of his mill was $36,000, pay-

able $12,000 in cash, $12,000 in preferred stock, and $24,000 in common stock. Of this amount $12,000 was a *bonus* of stock, or by way of division.

Hooker, as trustee for the Merchants' National Bank of Defiance, Ohio, and individually, owns 125 shares of preferred and 250 shares of common stock of the company (Rec., 101). In his option contract his selling price was $35,000, payable in cash $11,667, in preferred stock $11,666, and in common stock $22,333, making in all $46,666. Of this stock $11,666 was by way of *bonus* or division of stock, (Rec., 479.)

Hooker, individually, bought of Stein four bonds, each of the denomination of $1,000, and with them received a *bonus* of $2,400 of stock. (Rec., 149, 436.) His present holding may be made up, in part, of such stock.

Richardson, the remaining appellant, owns 150 shares of the preferred and 300 shares of the common stock, which were delivered under an option contract executed by him and his associates, and in part payment of his mill at Monroe, Michigan. (Rec., 101.) The option price was $40,000, payable $14,000 in cash, $13,000 in preferred stock and $26,000 in common stock, making a total of $53,000, of which $13,000 was a *bonus* or division of stock. (Rec., 479.)

Collectively appellants owned 785 shares of the 10,000 shares of preferred stock and 1,070 of the 30,000 shares of the common stock. Of the entire 1,855 shares held by them 1,217 shares were those acquired under their contracts as a *bonus* or gift.

Similar arrangements were made with the other mill-owners. In addition to his selling price each vendor was to be *given* an amount of common stock equal to one-

third the price of his mill. (Rec., 144.) The *bonus* or division so given to the vendors in the option contract amounted to about $700,000.

Stein, according to the option contracts, paid the mill-owners $766,000 cash, $629,000 preferred and $1,258,-000 common stock, making the amount of $2,653,000.

He sold each of the one thousand dollar bonds for $1,000 cash. Out of the one million dollars realized therefrom he gave the company $250,000 and the mill-owners $750,000, and he paid the mill men $16,000 additional in cash.

In selling the bonds it was found necessary to give the purchaser of each bond a *bonus* of $200 in preferred and $400 in common stock of the company. All the bonds were sold in this way to any one who would buy them. The larger part were sold to parties having no connection with or knowledge of the above transactions. A considerable part was purchased by parties more or less acquainted with the transactions.

Guggenheimer & Untermyer of New York city, sold bonds to many parties and purchased a considerable amount themselves. (Rec., 183.) The same was true as to Beard and others. A very considerable amount of the bonds were purchased by different mill owners. (Rec., 456.) In this way, Stein parted with $600,000 of the stock. Stein paid commissions for selling the bonds, but the rate or amount of such commissions is not shown. Every mill owner knew (Rec., 456) that the bonds were being sold and that with each bond was given twenty shares of the preferred stock and forty shares of the common stock. They were asked to take bonds on those terms. A number of them did so, including Hooker,

one of the appellants. (Rec., 456.) No objection was made to such procedure until after the commencement of the foreclosure suit.

Stein employed to assist him a firm of lawyers in New York city, highly experienced (Rec., 342) in aiding in the promotion of industrial corporations, and whose reputation appeared to be a guaranty that everything would be intelligently and efficiently perfected. Upon this firm fell the drafting of the option contracts, the arrangement of the entire plan by which the properties were to be acquired by Stein and the company through him, his disposition of the stock and bonds to pay mill owners and to discharge his own expenses, the preparation of bonds, stocks, trust deeds, and all the numberless details attending the creation and accomplishment of such a scheme. The transactions employed nearly a year. It appears that said firm was, like Stein himself, employed on a contingent basis; since had the scheme fallen down at any stage, they could have received no compensation. What Stein was to pay said firm or did pay them, or what would have been a reasonable compensation to them, does not appear. It is only shown that they rendered for the most of the year a very large amount of services in very important and intricate matters. It is shown that Stein employed a law firm in Chicago to examine the titles of the mill properties, drawing conveyances and doing other of Stein's work; that Stein paid said firm for said services $2,000 in cash, $8,000 in bonds, $1,600 in preferred stock and $33,200 in common stock. (Rec., 459, 460.) In all, $44,800, that such services extended over six months and were reasonably worth $50,000. (Rec., 491.)

It was shown that Stein paid $1,500 for recording fees. (Rec., 493.)

Also, that under an amendment of the original agreement between Stein and the company (Rec., 595), the company assumed notes on the purchased property amounting to $185,000, and received in return bonds and stock amounting to $476,000, making a gain to the company of $291,000.

Also (Rec., 495), that an additional sum of from $15,000 to $20,000 was paid by Stein to the company.

Also that Stein paid to other attorneys in connection with other matters relating to titles, $5,000 (Rec., 461). Also, in order to procure titles to the property within the time limited, he paid an additional sum for the Rockford mill (Rec., 477), the Clarkesville mill (Rec., 479), the Defiance mill (Rec., 479), the Marsailles mill (Rec., 480), the Lawrence Paper mill (Rec., 482), the Logansport mill (Rec., 482), and the Joliet mill (Rec., 482, 483). The amount of these additional sums was not shown by the evidence.

Stein also paid to the company an additional sum of $15,000 for certain stock. Stein employed to assist him in obtaining options Sherwood, Church, Trebein, Halladay and Beard. Of these, Church and Trebein were mill men who to a greater or less extent represented that class, as also did Halladay, who was a dealer in paper. Stein paid Sherwood for his services $25,000 in common stock (Rec., 340). It was not shown what he paid the other four for their services. He also paid the expenses of all.

Appellants contended that the sum of $2,113,000, being the difference between the par value of the stock

and bonds turned over to Stein by the company and the prime cost of the mills, represented an overvaluation of the property conveyed to the company, and that unpaid stock to that extent was issued to Stein and divided between him and the bondholders. Appellants, upon whom rested the burden of proving an overvaluation, made no attempt to fix the value of Stein's services, and but slight attempt to show his disbursement for the services of others, or the value of such other services, or the amounts disbursed by Stein in the prosecution of the enterprise beyond the amounts of the mill-men under the option contracts and the amount of stock which went as a part of the bond purchase.

In the above way $5,000,000 which Stein received from the company was expended by him, except the sum of $1,055,700 in stock. From this latter sum should be also deducted:

(1.) The amount of compensation which should be allowed Stein for nearly a year, for all his services anterior to the complete organization of the company, all his compensation having been contingent on his ultimate success.

(2.) The amount allowed by Stein to Beard, Church and Halladay and other millmen for their assistance in promoting the scheme. These services extended over a greater pait of the year and were on a like contingent basis. One of these assistants (Sherwood) shows that he was paid by Stein $25,000 in stock of the company.

(3.) The amount of the compensation from Stein to Guggenheimer & Untermyer for their services as counsel and assisting in all steps preliminary to the organization of the company, such services being on a like contingent basis.

(4.) All reasonable amounts allowed by Stein for services of other agents.

(5.) All expenses incurred and paid by Stein and his agents and assistants, including traveling expenses, hotel bills, office rent, printing and other matters.

(6.) Additional sums paid by Stein for five mills.

(7.) Amount paid by Stein as commission for selling bonds.

Appellants, upon whom the burden rested, introduced no testimony which will enable the court to determine as to the above amounts or as to reasonable charges for promotion.

Stein has owned no bond of the company since the commencement of the foreclosure proceeding. He parted with all he owned long before the commencement of the suit.

It was the belief of all parties that the earning capacity of the new company would be sufficient to earn a profit of more than $700,000 annually; that the cost of paper which had been $18 per ton, could by economic management and greater capital, be reduced to $16; that as an average sale price per ton for a term of years had been $26.83, it could be sold at $26; that 90,000 tons could be sold annually, thus showing a profit of $720,000; that this would pay six per cent. on the bonds, or $60,000; eight per cent. upon the preferred stock or $80,000; pass to the sinking fund $110,000 and pay at least fifteen per cent. dividends on the common stock. (Rec., 140, 145, 183, 184, 204, 488, 489, 588.) If but 50,000 tons could be sold, the profits would make the other payments and pay five per cent. on the common stock.

The Columbia Straw Paper Company continued in business until January 22, 1895. At that time it was insolvent. It had failed to discharge 100 of its bonds December 1, 1893, and 105 bonds December 1, 1894, as agreed (Rec., 219), and it had failed to pay the interest due on its bonds June 1, 1894, and December 1, 1894.

On January 22, 1895, a judgment was rendered against it in favor of James Flannagan (Rec., 224). The officers of the company facilitated the immediate entry of the judgment. Execution was at once issued but not paid or discharged. On the same day the trustees declared the principal and interest on the bonds to be immediately due and payable. They at once took possession of all the mortgaged property, and on January 24, 1895, filed their bill to foreclose the trust deed.

Brief.

I.

The one thousand bonds, each for $1,000, issued by the Columbia Straw Paper Company, and secured by the trust deed sought to be foreclosed, were valid outstanding bonds.

II.

The court did not, as alleged in the fourth error assigned for appellants, err in denying appellants leave to amend their answer in order to show that the organization of defendant company and the execution of its bonds and mortgage were parts of a scheme to form a trust or unlawful combination in restraint of trade. There was no such denial.

III.

The evidence fails to show that the organization of the Columbia Straw Paper Company and the execution of its mortgage and the issuance of its bonds was in pursuance of a scheme for the purpose of organizing a trust contrary to the laws of the State of Illinois, or the Statutes of the United States.

U. S. v. *C. E. Knight Co.*, 156 U. S., 1.
Thompson on Corporations, Sec. 6,400, 1.
Oakdale Mfg. Co. v. *Gast*, 28 Atl. Rep., 973.

Gibbs v. *Gas Co.*, 130 U. S., 396.
People v. *North River Sugar Refining Co.*, 54 Hun., 354.
Pittsburg Carbon Co. v. *McMillan*, 119 N. Y., 46.
Emery v. *Candle Co.*, 47 Ohio St., 320.
Mound River Coal Co. v. *Barclay Coal Co.*, 68 Pa. St., 173.
Arnot v. *Coal Co*, 68 N. Y., 558.
India Bag Assn. v. *Koch*, 14 La. Ann., 168.
State v. *Nebraska Distilling Co..*, 29 Neb., 700.
Richardson v. *Buhl*, 77 Mich., 632.
Craft v. *McConnoughy*, 79 Ill., 346.
People v. *Chicago Gas Trust Co.*, 130 Ill., 268.
Ford v. *Chicago Milk Shippers Assn.*, 155 Ill., 166.
Distilling Co. v. *People*, 156 Ill., 468.
Sharp v. *Taylor*, 2 Phillip's Ch., 801.
McBlair v. *Gibbes*, 17 How., 232.
Brookes v. *Martin*, 2 Wall., 70.
Natl. Distilling Co. v. *Cream City Co.*, 86 Wis., 352–355.
Dennehy v. *McNulta*, 86 Fed. R., 825–827.

IV.

Appellants are not creditors, and the rights of creditors are not involved in this suit.

V.

There was no fraudulent overvaluation of the properties conveyed by Stein to the defendant company, and hence, all the stock became fully paid.

Coit v. *Gold Amalgamating Co.*, 119 U. S., 343.

Ibid. v. *Ibid.*, 14 Fed. Rep., 12.

Bank of Fort Madison v. *Alden*, 9 Sup. Ct. R., 332.

1 Cook on Stockholder, Sec. 35.

2 Thompson on Corporations, Secs. 16–18.

Gamble v. *Queens County Water Co.*, 25 N. E. Rep., 20.

Young v. *Erie Iron Co.*, 31 N. W. Rep., 814.

Bickley v. *Schlag*, 20 Atl. Rep., 250.

Carr v. *Le Fevre*, 27 Pa. St., 113.

Huntington v. *Attrill*, 118 N. Y., 355.

Prospect Park R. R. v. *Coney Island R. R.*, 144 N. Y., 163.

VanFleet v. *Jones*, 75 Hun., 340.

Schenk v. *Andrews*, 57 N. Y., 133.

Boynton v. *Andrews*, 63 N. Y., 93.

Douglas v. *Ireland*, 73 N. Y., 100.

Lake Superior Iron Co. v. *Drexel*, 90 N. Y., 87.

Skinner v. *Smith*, 134 N. Y., 240.

Lorillard v. *Clyde*, 86 N. Y., 384.

Stewart v. *St. Louis R. R.* (Neb.), 41 Fed. R., 736.

N. W. M. Life Ins. Co. v. *Cotton Exchange*, 75 Fed. R., 155.

Natl. Tube Works v. *Gilfillan*, 124 N. Y., 302.

Grant v. *E. & W. R. R. Co.*, 54 Fed. R., 569.

Commonwealth v. *Central Passenger Co.*, 52 Pa. St.. 506–515.,

Carr v. *LeFevre*, 27 Pa. St., 413.

Fogg v. *Blair*, 139 U. S., 118.

Clark v. *Bever*, 139 U. S., 96.

Handley v. *Stutz*, 139 U. S., 417.

Danville R. R. Co. v. *Kase*, 39 Atl. R., 301.

Whitney Arms Co. v. *Barton*, 63 N. Y., 62.

VanDyke v. *McQuade*, 86 N. Y., 38.

Whitney v. *Camman*, 137 N. Y., 344.

White v. *Jones*, 86 Hun., 59.

Monongahela Co. v. *U. S.*, 148 U. S., 328.

Washburn v. *Natl. Wall Paper Co.*, 81 Fed. R., 17.

VI.

The defendant corporation could not maintain an action or defense such as was set up by appellants.

1 Cook on Stockholder, Secs. 38–47.

Scovill v. *Thayer*, 105 U. S., 143.

Foreman v. *Bigelow*, 4 Cliff., 508.

Brant v. *Ehlen*, 59 Md., 1.

Phelan v. *Hazard*, 5 Dillon, 43–52.

Coffin v. *Ransdell*, 11 N. E. Rep., 20.

First Nat. Bank of Deadwood v. *Mining Co.* (Sup. Ct., Minn.), 44 N. W., 198.

Du Pont v. *Tilden*, 42 Fed. Rep,, 87.

New Jersey Corporation Laws, Sec. 55.

Hebbard v. *Southwestern L. & C. Co.*, 36 Atl. R., 122.

First Natl. Bank v. *Guston*, 42 Minn., 327.
Krohn v. *Williamson*, 62 Fed. Rep., 869.
Williamson v. *Krohn*, 66 Fed. Rep., 655.
Wells v. *Green Bay Co.*, 90 Wis., 442.
Proctor Land Co. v. *Cook* (Ky.), 44 S. W. Rep., 391.
Granite Roofing Co. v. *Michael*, 54 Md., 65.
Re Ambrose Lake Co., L. R., 14 Ch. Div., 390.
St. Louis R. R. Co. v. *Tiernan*, 37 Kan., 606.
Foss v. *Blair*, 139 U. S., 118.
Clark v. *Bever*, 139 U. S., 96.
Hundley v. *Stoltz*, 139 U. S., 417.
Union Loan & Trust Co. v. *Road Co.*, 51 Fed. R., 840.
Smith v. *Ferris Co.* (Cal.), 51 Pac. R., 710.

VII.

Nor can appellants assert such a defense or a stock liability on behalf of the company.

VIII.

Appellants cannot, as stockholders, maintain a proceeding to enforce payment by the bondholders of their alleged unpaid stock for a fraudulent overvaluation since appellants participated and acquiesced in the transaction.

1 Cook on Stockholders, Secs. 39, 40.
In re Gold Company, L. R., 11 Ch. Div., 701–12.
Hinckley v. *Pfister*, 53 N. W. Rep., 21.
Callaman v. *Windsor*, 78 Iowa, 193.

Lewis v. *N. Y., etc., Iron Co.*, N. Y. Law Journal, Apr. 30, 1890.

Clark v. *American Coal Co.*, 86 Iowa, 436.

Wood v. *Correy R. R. Co.*, 44 Fed. R., 146.

In re Syracuse R. R. Co., 91 N. Y., 4.

Barr v. *R. R. Co.*, 125 N. Y., 373.

Kent v. *Quicksilver Mining Co.*, 78 N. Y., 159–188.

Parsons v. *Hayes*, 14 Abb. N. C., 419.

Langdon v. *Fogg*, 18 Fed. R., 8.

Thompson v. *Bemis Water Co.*, 127 Mass., 595.

McGeorge v. *Big Stone Gap Imp. Co.*, 57 Fed. R., 262.

Washburn v. *Natl. Wall Paper Co.*, 81 Fed. R., 21.

Ten Eyck v. *Pontiac Co.* (Mich.), 72 N. W. R., 362.

Nicrosi v. *Calera Co.* (Ala.), 22 So. R., 147.,

Woolfolk v. *January*, 131 Mo., 620.

Drake v. *Suburban Water Co.*, 26 App. Div. (N. Y.), 499.

Unkeles v. *Colgate*, 148 N. Y., 529.

Natl. Wall Paper Co. v. *Hobbes*, 90 Hun., 288.

Parsons v. *Hayes*, 14 Abb. N. C., 419.

Morawetz Private Corporations (2d Ed.), Sec. 290.

Langdon v. *Fogg*, 18 Fed. R., 8.

Seymour v. *Spring Forest Assn.*, 144 N. Y., 341.

1 Pomeroy's Eq. Juris., 401, 402.

Waterman on Set-off, pp. 3, 469, 470.

IX.

Where all the bonds and stock of a company are conveyed for property which the company acquires, all *THEN* stockholders assenting, neither the company nor any then or subsequent stockholder can complain.

Scovill v. *Thayer*, 105 U. S., 143.

Higgins v. *Lansingh*, 154 Ill., 133.

Coffin v. *Ransdell*, 110 Ind., 417.

Foster v. *Seymour*, 23 Fed. Rep., 65.

Stewart v. *R. R. Co.*, 41 Fed. Rep., 736.

St. L. & Ft. S. & W. R. R. Co v. *Tiernan*, 37 Kan., 606.

X.

No fraud or circumvention was practiced on appellants.

XI.

In no view of the case can any relief be granted against the stockholders of the Columbia Straw Paper Company in this action brought in a forum other than that of New Jersey, the laws of which regulate this corporation.

Erickson v. *Nesmith*, 4 Allen, 233.

New Haven Horse Nail Co. v. *Linden Springs Co.*, 142 Mass., 349.

Bank v. *Rindge*, 154 Mass., 203.

Marshall v. *Sherman*, 148 N. Y., 9.

Barnes v. *Wheaton*, 80 Hun., 8.

Lowry v. *Inman*, 46 N. Y., 119.
Young v. *Farwell*, 139 Ill., 326.
Fowler v. *Lamson*, 146 Ill., 472.
Patterson v. *Lynde*, 112 Ill., 196.
Id., 106 U. S., 519.
May v. *Black*, 77 Wis., 101.
Nimick v. *Iron Works Co.*, 25 W. Va., 184.

XII.

The court did not err, in striking appellants' cross-bill from the files.

Thomas v. *Brownville R. R.*, 109 U. S., 526.
Lund v. *Skane Enskilda Bank*, 96 Ill., 181.
Cross v. *DeValle*, 1 Wall., 1.
American Co. v. *Marquans*, 62 Fed. Rep., 660.
1 Foster's Fed. Prac., Sec. 171.
2 Daniel Chan. Prac., 1551.
Forbes v. *Memphis R. R.*, 2 Woods, 323.
Deery v. *Gray*, 5 Wall., 795.
Gregg v. *Moss*, 14 Wall., 564.

Allis v. *Ins. Co.*, 97 U. S., 144.
Gammon v. *Pratt*, 99 U. S., 619.
Mining Co. v. *Taylor*, 100 U. S., 37.
Hornbuckle v. *Stafford*, 111 U. S., 389.

XIII.

There was no necessity for a production of the bonds before the master.

Toler v. *East Tennessee R. R.*, 67 Fed. Rep., 168.
Guaranty T. & S. Dep. Co. v. *Green Cove Springs Co.*, 139 U. S., 150.

XIV.

There was no collusion or fraud in connection with the Flannagan judgment and the issuing of an execution thereon, and the proceedings by reason thereof.

Standard Dictionary, "Collusion."
Anderson's Dictionary of Law, "
Bouvier's Law Dictionary, "
Gottlieb v. *Miller*, 154 Ill., 52.
Ill. Steel Co. v. *O'Donnell*, 156 Ill., 630.
Fogg v. *Blair*, 133 U. S., 534.
Farmers Loan & Trust Co. v. *Green Bay Co.*, Fed. R., 100-110.
County of Leavenworth v. *Chicago, etc.*, 25 6 Fed. R., 229.
Toler v. *East Tennessee Ry. Co.*, 67 Fed. R., 168–177.

XV.

There was no need for demand against the defendant company for the payment of interest.

XVI.

The bonds were negotiable instruments.

XVII.

Complainants were mortgagees in possession when they filed their bill alleging that they held the property in trust for the bondholders. As such trustees they could maintain their bill.

SYNOPSIS OF ARGUMENT.

1. The bonds of the company were valid outstanding bonds. They were paid for at their par value.

2. The court did not err in refusing appellants leave to amend their answer so as to set up the defence that the execution by the company of its bonds and mortgage was part of a scheme to create a monopoly restraining trade or creating an illegal trust. Such amendment was made by appellants without objection from court or counsel.

3. The Circuit Court considered this trust question, and held that the evidence did not disclose an illegal combination or arrangement. No such combination appears from the testimony. Appellants abandoned this contention in the Court of Appeals. The unification of some competing plants is not obnoxious to the law. The company operated but sixteen mills, and it had thirty active competitors. It could not hope to and did not control prices or destroy competition.

4. Appellants are not creditors, and the rights of creditors are not involved in this suit. The rights of minority stockholders are very different from those of creditors, and the authorities cited for appellants, so far as they involve the rights of creditors, have no application here.

5. There was no overvaluation; at any rate,

no fraudulent overvaluation of the properties conveyed to the Columbia Straw Paper Company. Hence the stock of the company was fully paid, and there is no liability on the part of the stockholde

6. The contract whereby Stein was to convey to the company the properties and cash called for by the contract and the company was to deliver to him stock and bonds of the company, was fully executed by both parties. There was no stock subscription, unless that contract may be considered as such. The company cannot retain the mill plants and cash and at the same time compel the parties who received the stock to pay what they never agreed to pay. There is no attempt to rescind the contract and return the considerations. Hence there is no stock liability.

7. As the company could not compel such payment, no stockholder acting on its behalf could do so.

8. If there was any overvaluation, fraudulent or otherwise, appellants knew of it, actively participated in it, partook of its fruits, are in equal wrong with the parties against whom they bring charges, and are in no position to ask the intervention of a court of equity. Being **in pari delicto** *they are not entitled to relief.*

9. By agreement all the bonds and stock of the company were conveyed for property which the company thereby acquired. Appellants ac-

sented thereto, as did all then stockholders, and appellants, or the parties under whom they hold stock, acquiesced in the transaction until after the failure of the company. As all parties then in interest assented, no one was injured, and no one can complain, the rights of creditors not being involved.

10. Especially is this true since no fraud, concealment, artifice or deceit was practiced on appellants, or any one. Appellants had actual as well as constructive notice of all that was done.

11. This is, in effect, a proceeding to enforce a stockholder's liability against bondholders. The remedies against stockholders whose stock is unpaid are created by the statutes of New Jersey, under whose laws the corporation was organized. Only such remedies can be pursued, and they can be enforced only in the courts of that state.

12. It was not error to strike appellants' cross-bill from the files. They filed their cross-bill, not by legal right, but by permission of the court, which always retains control of its interlocutory orders. The court, on inspection of the cross-bill and the evidence, rightly concluded that it was not such a cross-bill as appellants were entitled to file under its leave, and hence withdrew its permission. The cross-bill must have been dismissed on demurrer or on final hearing for want of equity, and the complaint of appellants is, not that their bill was dismissed, but that it was dismissed in an erro-

neous manner. If this were true it was error without prejudice, and is not ground for reversal; but it was not error to strike it from the files.

13. There was no necessity for the production of the bonds before the master. Complainant trustees were not the holders or owners of the bonds. The mortgage binding upon the company and upon appellants allowed a foreclosure by the trustees without such ownership on proof that the bonds were issued and outstanding, and that default had been made, etc. This proof was made In such case, where complainants are not bond-owners, the production of bonds before a nisi decree of sale is never ordered, and such order would be a practical denial of justice.

14. There was no collusion or fraud in connection with the Flannagan judgment, the execution issued thereon, or the proceedings of the trustees by reason thereof. All of the property of the company was mortgaged. It was insolvent and unable to carry on business without a conversion of its mortgaged property. Accordingly, it properly allowed judgment to go against it and its property to be taken by its mortgagees. The company might lawfully give to its creditor all its property. There was no fraud, no dishonesty and no illegal collusion. This was not a case of a corporation able to conduct business which was strangled by a greedy creditor.

15. There was no necessity under the mortgage

for any demand against the company for payment of interest. There was full evidence that the company had defaulted in its interest. There was no necessity for any request by the bondholders to the trustees to take possession, although such request was made.

16. It was immaterial whether the bonds were negotiable instruments, although in fact they were.

17. The complainants were mortgagees in possession, declaring that they held in trust for the bondholders. Should the court decline their prayer they would become the absolute owners.

ARGUMENT.

I.

The 1,000 bonds, each for $1,000, issued by the Columbia Straw Paper Company, and secured by the trust deed sought to be foreclosed, were valid outstanding bonds.

They were issued by the company to Stein, in part payment for the properties conveyed by him to the company, and were sold by him and paid for at their par value by purchasers from him. Of the $1,000,000 received by him on such sale, he paid to the mill vendors $766,000, being the cash payment called for by the option contracts, and paid the remainder to the company. (Rec., 407.) The validity of the bonds, it would seem, could not be questioned, and is not questioned by the petitioners except in so far as their validity may be affected by the "trust" question. The propositions in their brief do not raise a question as to their validity except on said ground; neither do their "Points of Argument" nor their argument itself. The pleadings of petitioners and their contentions in the Circuit Court and Court of Appeals, as well as here, are that there is a stock liability on the part of the bondholders which can be set off against the bonds. In this proceeding respondents deny such liability upon the following grounds:

II.

The court did not, as alleged in the 4th error assigned for appellants, err in refusing to permit appellants to amend their answer by the amendments to said answer tendered for the purpose of showing that the organization of the Columbia Straw Straw Paper Company and the execution of the mortgage to said appellees was in pursuance of a scheme for the purpose of organizing a trust contrary to the laws of the State of Illinois and the Statutes of the United States.

An examination of the record discloses that the original bill to foreclose was filed January 24, 1895, (Rec., 2), the answer of the defendant company was filed March 22, 1895, (Rec., 70), admitting all the substantial allegations of the bill. The original answer of appellants, admitted as defendants by leave of court, was filed May 18, 1895. (Rec., 74.) October 10, 1895, the issues were referred to the master to take proofs and report. (Rec., 215.) The court entered an order for parties to close their proofs by certain dates. (Rec., 215.) The time for appellants to close proofs expired November 30, 1895. It was extended on their motion to December 19, and again to December 30, and finally to January 6, 1896, when the court refused further to enlarge the time. (Rec., 265.) February 9, 1896, after the proofs were closed, appellants filed their amended answer. (Rec., 256.) In this answer appellants alleged that the bonds and mortgage sought to be foreclosed were parts of a combination or trust in re-

straint of trade, that such combination constituted a monopoly at common law and was in direct violation of an Act of Congress of the United States entitled, "An Act to Protect Trade and Commerce against Unlawful Restraint and Monopolies," approved July 2, 1890, and that the same was in violation of an Act of the General Assembly of the State of Illinois, entitled "An Act to Provide for the Punishment of Persons, Partnerships or Corporations forming Trusts, Pools and Combines, and Mode of Procedure and Rules of Evidence in such Cases," approved June 11, 1891, in force July 1, 1891.

The amended answer set out at length the alleged facts to support such charges. It averred *inter alia* (Rec., 257) that there were seventy mills engaged in the manufacture of straw paper, all in competition with each other; that the company obtained control of forty of the mills and operated but sixteen. (Rec., 263.)

The answer as so amended afforded appellants every opportunity to avail themselves of the "trust" or "monopoly" defense so far as the evidence tended to support it.

The court did not refuse permission to appellants to file this amended answer. On the contrary, it was filed and remained a part of the files and of the pleadings in the cause without objections from the court or counsel for the other parties to the suit. The claim that the court refused leave to file the amended answer rests upon misapprehension.

Leave to make a further amendment was sought on behalf of appellants, but as no showing was made as to the nature of such amendment or as to any necessity for it, the motion was denied (Rec., 264) and properly de-

nied, and there was no error in such denial. Certainly no further amendment was requisite to enable appellants to set up the trust or monopoly defense outlined in the fourth error assigned for appellants.

III.

The evidence fails to show that the organization of the Columbia Straw Paper Company and the execution of its mortgage to appellee, and the issuance of its bonds was in pursuance of a scheme for the purpose of organizing a trust contrary to the laws of the State of Illinois and the Statutes of the United States.

The history of this "trust" defense, as shown in the record, is as follows:

Before appellants filed their amended answer, February 9, 1896 (Rec., 257), and on January 10, 1896, Charles A. Miller filed his petition (Rec., 240) to be made a party defendant, and to set up the trust or monopoly defense. His petition sets out (Rec., 243) with great particularity the trust theory. The petition, its various affidavits and *all the testimony in the case* was submitted to the examination of the court. Several days were consumed upon the argument, in reading the testimony and citing the decisions applicable. The court then took the matter under advisement. (Rec., 255, 256, 264.) Finally on March 4, 1896, it denied the petition. (Rec., 264.) The opinion of the court in so doing was as follows:

> "There are a number of motions in this case that I propose to dispose of. The first is the appplication of Miller to be made party defendant, with

leave to make the answer appended to his motion. I read over Mr. Miller's petition very carefully, and I understand the situation to be about as follows: He says that there were seventy paper mills in the territory between Pittsburgh and St. Paul, and that a movement was made by the owners and certain other parties to combine all those seventy mills; that they had an understanding among themselves that such a combination was to be made, and they started out to carry that intent into execution; that option contracts were made with thirty-nine or forty of these mills, and he insisted that the purpose was to take in the entire seventy mills, and stop competition between them in the manufacture of wrapping paper. It seems that thirty-nine of these options were obtained, and they passed into the hands of Mr. Stein. Afterwards Stein sold these mills to the defendant in this case, and the defendant, undertaking thereupon to go into the business of manufacturing wrapping paper, operated nineteen of these mills. Four were burned up, it seems, and for some reason, I suppose because of want of capital, or because it would not pay, the defendant started to operate but nineteen. That left thirty-one mills in the territory, and in competition with this defendant. Some of these thirty-one mills were very large concerns, it seems. Now, I cannot gather from that statement that the defendant, in fact, secured any monopoly of the business of manufacturing straw paper, and I cannot infer from what the defendant has done that it could have had the intent to create a monopoly in the business of making wrapping paper. I hardly think that wrapping paper, anyhow, could be regarded as an article of prime necessity, and, as I understand it, it is a commodity that can be made most anywhere in the temperate zone where straw grows. The idea of any concern getting up a monopoly on that article seems to me exceptional. However that may be, I don't think that I can properly say that this defendant ever had any intent to secure a monopoly in the manufacture of that article. The fact is that the other defendants here,

Dickerman and others (appellants), make it a veiy prime ground for complaint that the combination was not carried into effect.

"Sherwood and the parties he represents seem to think they were wronged because the entire seventy mills were not obtained, and monopoly to that extent and as far as it could be carried on established. At any rate, I do not see how the complainant in the case, which is a mere trustee for bondholders, some of whom may have been in the scheme, and others not—I do not see how any intent of that sort could be an objection to the complainants' suit.

"I do not think the contract between Stein and the defendant was intended for the purpose of creating a monopoly, or that it tended to created a monopoly, or that the contract had for its purpose a monopoly in fixing the price or limiting the quantity of straw paper as defined in the Illinois statutes. Of course, the defendant company could fix the price of its own commodity, the paper that it manufactured, just the same as any other manufacturer could, and the defendant could limit the quantity of its own output, just as any other manufacturer could. I do not understand that to be the thing that the statute is aimed at, or that is inhibited by the common law. In all questions like this the courts assume that the right between men is exercised peremptorily. The right of contract is the important thing that the courts have to protect. It is necessary for civilization and society that contracts that men make with one another be respected and enforced, and whenever a contract has been attacked on the ground that it is against public policy, the courts have said time and time again that the presumption is in favor of the contract, and that the burden is upon the party that claims its invalidity. Public policy is something that may be one thing to-day and something else to-morrow. It is a very uncertain quantity. A court ought to be very sure of its ground before breaking down a contract for that reason. I should not feel justified in undertaking to impeach

this contract for the reason that it is against public policy or against the Illinois statute, because I can not say that it is. At least, I cannot see clearly enough to take the responsibility of such a ruling.

"*There is another point in this connection that has not been referred to by counsel on either side. The complainants in this case are trustees. That is what is shown on the face of the bill. They have the legal title of the property, and not only that, they were in possession of it at the time they filed this bill. Now, if I should make a ruling here that these contracts were void or non-enforcible in a court, the effect of that would be to leave all this property in the hands of these complainants. It could not be taken from them. It seems to me great wrong would be done if I should make that ruling.*

"*Now we can say, taking the statements of these complainants in the bill filed by them, even upon the assumption that the bonds are void as contracts and that the mortgage is also void, there still remains this bill and the assertion on the face of it that these complainants hold this property in trust, first, to pay the people that hold the bonds, and secondly for this company. Now, an owner of property may declare a trust if he wants to. He may do it by writing if he feels like it, even without consideration, and having done so, vest the equitable interests in the beneficiaries. Even on that theory, this bill, it seems to me, might be made to go. I could not turn complainants out of court who insist that they have a great fund of property for certain beneficiaries.*

"The provision of the statute of frauds is the old English statute, which says that an express trust can only be approved or manifested by some writing, but it is not a case of proof here. The trust is valid on the face of the bill. In the case of *Butler* v. *Port Arlington*, in 1 Connor & Lawson Chancery Repts., four parties filed a bill for specific performance of an agreement to renew a lease. It was stated on the face of the bill that the title had come to *A* by a conveyance from a former owner, and that a trust was declared for *B*. In other words, it was

> stated in the bill that the complainant *A* held his interest in trust for the complainant *B*. On the hearing of the case the objection was made, for it turned out by a further showing that the deed of conveyance from *A* to *B* contained no declaration of trust at all. It was therefore insisted at the hearing that the bill would have to be dismissed because *B* had no interest, but the court held that the declaration in the bill that there was a trust by *A*, that the property was held by him in trust for the owner, was sufficient to give the equitable interest to *B*, and that therefore in that case he did have an interest, and it was properly applied. This ruling was made by the Lord Chancellor of England.
>
> "I mention that as illustrating the point I have referred to as the state of this case, even upon the showing that these bonds were void and non-admissible. Therefore, this being the view I take of it after reading over these documents very carefully and with a great deal of interest, I think I shall have to deny Mr. Miller's application to be made a party defendant. I think it would be a very exceptional thing if I should sustain it, and undertake to dispose of the case on that theory."

Thereafter appellants accepted this as the conclusion of the court upon the question, and did not urge the defense set up by their amended answer. They did not attempt to maintain it before the master, and his report does not allude to it. (Rec., 265.) They did claim the validity of such defense in their exceptions to the master's report (5th exception to master's report, Rec., 512), but did not press their contention upon the hearing upon the exceptions which were overruled. (Rec., 525.) On the hearing before the Court of Appeals appellants silently abandoned this contention, and hence the opinion of that court makes no reference to the question. (Rec., 571.) In appellants' petition and brief for rehearing before the

Court of Appeals (Rec., 581) no claim arising out of or connected with this trust question was made.

As appellants practically abandoned this defense in the trial court and wholly abandoned it in the Court of Appeals, they are not entitled to favorable consideration when they urge this defense in this court. And the defense is not seriously pressed here.

If this question whether the mortgage and bonds are such as a court of equity will refuse to enforce because they are parts of a scheme to form an unlawful trust or monopoly,—a position abandoned by appellants in the lower court and urged here by appellants who were active participants in whatever was done,—is to be entertained in this court, it is submitted that the answer must be in the negative.

1. The mortgage and bonds are not obnoxious to any Federal Act. The act referred to relates solely to inter-state commerce, and has no application here.

U. S. v. *E. C. Knight Co.*, 156 U. S., 1.

2. They are not condemned by the common law, nor by the act of the General Assembly of the State of Illinois, entitled "An act to provide for the punishment o persons, copartnerships or corporations forming trusts, pools and combines and modes of procedure and rules of evidence in such cases."

There is no dispute as to the facts. They are that in the territory in which the mill plants were located, there were seventy mills engaged in manufacturing wrapping paper, *all of which were in active competition with each other* (amended bill, Rec., 257); that the Columbia Straw Paper Company acquired but forty of these mills, leaving thirty active competitors outside; that these outside mills

in size and producing capacity were the equals of those purchased (Rec., 383); that said company never purchased, and never intended to purchase any of said thirty competing properties; that three mills so purchased were destroyed by fire, that four were dismantled as of no value except for machinery, and that of its remaining thirty-three mills the company operated but sixteen, which produced more than could be sold (amended answer, Rec., 262–263), and that while the company continued in business it operated but sixteen mills and had thirty active competitors. Under these circumstances it was impossible that the company could control the price of wrapping paper or obtain a monopoly in its manufacture and sale, or that, however visionary its stockholders or officers might be, that it could hope that seventeen mills could dictate to thirty. There is no evidence that it did control prices, or create a monopoly. There is no evidence that it limited or attempted to limit the output of wrapping paper. So far as the testimony shows the company manufactured all and more than it could sell. There is no evidence that the company arbitrarily attempted to or did increase or decrease the price of wrapping paper, or that any change in such price after the organization of the company was anything else than a result produced among many competitors by the natural laws relating to supply and demand. It is evident that any attempt of said company to sell wrapping paper below the cost of production would have been suicidal, and any attempt to demand more than such cost, and a fair and reasonable profit, would have made sales impossible, and thrown all business to the thirty competitors, and any new competitors which might spring up.

The company, then, never attempted to acquire, and

never did acquire a monopoly. It never limited or attempted to limit the manufacture or output of wrapping paper. It never regulated or fixed, or attempted to reglate or fix, the price of paper aside from the ordinary laws of trade.

If any promotor or mill-owner, at any time contemplated a purchase of substantially all the competing plants, or a purchase of so many as that the Columbia Straw Paper Company could control the price of straw paper, or obtain any approach to a monopoly, such purpose was abandoned before Stein acquired the properties or conveyed them to the paper company. Indeed, it is urged by appellants as a great grievance, and a breach of good faith that Stein and the company did not purchase to an extent to make such results possible.

The Columbia Straw Paper Company died from *excess of competition*, coincident with the immense decline in the demand for wrapping paper which attended the "panic," and because the selling price of paper was wholly outside its control. As it was not a monopoly, as it could not control prices or regulate any output but its own, as it was subjected to a fierce competition, and as its organization was soon followed by a general financial depression, it was moribund from that time, and its early death is in part attributable to the fact that it wholly lacked the illegal powers with the use of which it is charged.

It is plain that the entire gravamen of the charge against the Straw Paper Company is the acquisition by it under the circumstances of thirty-nine properties theretofore owned by different corporations, partnerships or individuals, with no purpose to create a monopoly, regulate prices or output. By economic methods the com-

pany might manufacture more cheaply than any one of its predecessors, and might sell to better advantage, and that is all that it hoped or could hope to accomplish, and such act or purpose is not prohibited by law.

Certainly, at common law, the purchase by an individual, partnership or corporation of the property of another, or others engaged in the same business is not against public policy, and the reasons are the same as to each class. The corporation, so far as it does not act *ultra vires* its charter powers, stands upon the same plane as the individual or the firm.

And provisions whereby the vendor was to refrain for a limited time in a limited district, from engaging in the same business, have been sustained with much unanimity.

In *Oakdale Manufacturing Co.* v. *Gast*, 26 Atlantic R., 973 (Sup. Ct. R. I.), the facts were these:

All the manufacturing companies of New England engaged in a certain business, except one, had turned in their stock at an over-valuation to a new company, taking an amount of stock in the new company represented by such over-valuation. The sellers agreed not to carry on a like business for a term of years. The bill was for an injunction by the company against one of the parties to restrain him from violating his covenant. The answer of defendant was that this contract was void, as a combination to raise the price of a necessary or useful commodity in trade and to stifle competition.

The court said:

> "Undoubtedly there may be combinations so destructive of the right of the people to buy and sell and to pursue their business freely that they must be declared to be void on the ground of public policy. In such cases *the injury to the public is the control-*

ling consideration. But it does not follow that every combination in trade, even though such combination may have the effect to diminish the number of competitors in business, is therefore illegal. Such a rule would produce greater public injury than that which it would seek to cure. It would be impracticable; it would forbid partnerships and sales by those engaged in a common business. It would cut off combinations to secure the advantages of united capital and economy of administration, and hamper the familiar conduct of business in many ways. There may be many such arrangements which will be beneficial to the parties and not injurious to the public. Monopolies are liable to be oppressive, hence are deemed to be hostile to the public good, but combinations for mutual advantage which do not amount to a monopoly, but leave the field of competition open to others, are neither within the reason nor the operation of the rule. * * * Here there is no monopoly. Three out of four of the companies in New England in this line of manufacture agreed to unite, one inducement being to stop the sharp competition then existing between them. But even so, not only is the field open to the other company, equal in strength to either of these, but it is also open to competition from companies in other parts of the country and to the formation of new companies. This is neither a monopoly nor such an approach to it as amounts to the same thing. It is the common occurrence of a consolidation of firms. It is not illegal on the ground of reducing competition."

THOMPSON, in his latest and most complete work on corporations, says (6400, 6401), that

"A voluntary dissolution of all competing companies and the formation of a single corporation under the statutes of some state, the new corporation becoming the purchaser of all the properties of the antecedent corporations and the shareholders in such corporations receiving shares in the new corporation upon the basis agreed upon in the scheme of such incorporation, is not an illegal act."

Of course the actual unification of what were properly distinct concerns differs from an agreement or combination of such distinct concerns made merely for the purpose of controlling prices and preventing competition. The law has placed no limit upon the amount of property which an individual or partnership may lawfully acquire or hold, nor is the individual subject to legal attack because the extent of his wealth is such that he may at times prevent competition or regulate prices. The same is true of corporations, with the qualification that their capital and the nature of their business is limited by their charters. When they keep within these limitations we can see no reason why the corporation may not acquire what the individual may acquire. We believe there are no well considered cases supporting a different conclusion.

The Act of the General Assembly of the State of Illinois relied on in the amended answer is as follows:

> "If any corporation organized under the laws of this or any other state or country for transacting or conducting any kind of business in this state, or any partnership or individual or other association of persons whosoever, shall create, enter into, become a member of or a party to any pool, trust, agreement, combination or understanding with any other corporation, partnership, individual or any other person or association of persons to regulate or fix the price of any article of merchandise or commodity, or shall enter into, become a member of or a party to any pool, agreement, contract, combination or federation to fix or limit the amount or quantity of any article, commodity or merchandise to be manufactured, mined, produced or sold in this state, such corporation, partnership or individual or other association of persons shall be deemed and adjudged guilty of a conspiracy to defraud and be subject to indictment and punishment as provided in this act."

By subsequent sections fines are imposed for the violation of the act, and contracts or agreements in violation thereof, are declared void.

Of course, the above act, if it affected the validity of the mortgage in suit, could only affect it as to properties situated in the State of Illinois.

While that law prohibits, as did the common law, individuals and corporations from entering into pools, trusts, combinations, confederations or agreements of distinct parties to accomplish the inhibited purpose, it does not prohibit individuals or corporations from acquiring by actual purchase any number of properties.

That law has received a construction in the courts of Illinois, but not such a construction as appellants contend for in this case.

The Illinois cases are as follows:

Craft v. *McConoughy*, 79 Ill., 346.

That was the case of a combination of several different individuals to control prices.

People v. *Chicago Gas Trust Company*, 130 Ill., 268.

This was an information in the nature of *quo warranto* by the attorney-general against the defendant, a gas company which had acquired a majority of the stock of *all* the gas companies doing business in Chicago, and which controlled, or was in a position to control, such business. It was held that such a corporation organized to manufacture and sell gas, had no charter power to purchase or sell shares of stock in other gas companies, even though such power was specified in its articles of incorporation; that the control by said company of the four remaining

companies, outside and independent corporations, actually suppressed competition between them and creat[ed a] virtual monopoly and was illegal. The case was where the gas company, by its purchase of stock, controlled all the gas companies. The court said (p. 301):

> "When the four gas companies entered the streets of Chicago, they assumed the performance of the public duty of furnishing light to the inhabitants; that they should be permitted or required or forced to abandon the performance of such public duty is against the policy of the law. The public duty is imposed upon each company separately, and not upon the four when combined together. Each for itself, when it accepted its articles of association, assumed an obligation to perform the objects of its incorporation, but the appellee through the control which it does or may exercise over the four companies by reason of its ownership of a majority of their stock renders it impossible for them to discharge their public duties, except at the dictation of an outside force and in the manner prescribed by a corporation operating independently of them. They are thus virtually forced to abandon the peformance of their duty to the public; the freedom and effectiveness of their action in carrying out the purposes of their creation are seriously interfered with, if not actually destroyed. A power whose exercise leads to such a result cannot be lawfully entrusted to any corporate body."

Ford v. *Chicago Milk Shippers' Association*, 155 Ill., 166.

There a corporation was formed for the purpose of regulating the price and the quantity of milk sold. The plan as the court stated it was this:

> "Appellee receives milk from members and accounts to them for the same; guarantees payment to members; fixes and determines the price of milk; retains five cents upon each can of milk sold for

> each year; has authority over all milk consigned by any of its members to any stand within the corporate limits of the City of Chicago; a member cannot sell his stock except to a shipper and producer of milk, and must own as many shares as he ships cans of milk per day, but not to own more than fifty shares of stock."

Here was a combination between the corporation and fifteen hundred milk producers who became members of the association and agreed to be bound by its rules.

The Distilling and Cattle Feeding Company v. *The People ex rel.*, 156 Ill., 448.

This was a proceeding by *quo warranto*. This company was preceded by an unincorporated association called "The Distillers Cattle Feeding Trust," which was a combination between the various distilling companies of the country to pool their interests through trustees, who held all the stock of all the corporations engaged in such business. The trustees obtained possession of nearly all the distilleries and of nearly the entire distilling product of the United States, dictated prices and the amount of production, and thus drew to themselves the substantial control of the distilling business of the country. Their scheme was in fact intended to and actually did control prices, destroy competition and create a monopoly.

These trustees organized themselves into a corporation and subscribed for all the stock. The court said:

> "The trust, then being repugnant to public policy and illegal, it is impossible to see why the same is not true of the corporation which succeeds to it and takes its place. The control exercised over the distillery business of the country—over-production and prices—and the virtual monopoly formerly held by

> the trust are in no degree changed or relaxed, but the methods and purposes of the trust are perpetuated and carried out with the same persistence and vigor as before the organization of the corporation. There is no magic in a corporate organization which can purge the trust scheme of its illegality, and it remains as essentially opposed to the principles of sound public policy as when the trust was in existence. It was illegal before and is illegal still, and for the same reasons. * * * Defendant's power to acquire and hold property is limited to that purpose, and it has no power by its charter to enter upon a scheme of getting into its hands and under its control all or substantially all the distillery plants and the distillery business of the country for the purpose of controlling production and prices, of crushing out competion and of establishing a virtual monopoly in that business. Such purposes are foreign to the powers granted by the charter."

An examination of the cases in Illinois courts since the passage by the Illinois legislature of its act relating to trusts, pools, etc., shows that combinations of different persons, partnerships and corporations to regulate prices and output and to prevent competition are illegal, and that corporations which succeeded to such illegal combinations, and which actually created monopolies, regulated prices and destroyed competition, exceeded their legal powers under the laws of Illinois relating to cor porations, and were illegal.

It does not appear that a corporation which under charter authority has purchased a number of other corporations engaged in a like business and has unified the properties into a single ownership, and which has not and cannot regulate prices, destroy competition or create a monopoly is illegal under the common law or that of Illinois.

Appellants cite cases which may be grouped into two classes, each of which is wholly dissimilar to the case before the court:

1. Where there was a pool between different companies or individuals engaged in the same business, the object of which was to regulate output, control prices and prevent competition. The following are cases of that class.

Craft v. *McConoughy*, 79 Ill., 346.

Gibbs v. *Gas Co.*, 130 U. S., 396, 9 Sup. Ct. R., 553.

People v. *North River Sugar Refining Co.*, 54 Hun., 354, 7 N. Y. Supp., 406.

People ex rel. v. *Chicago Gas T. Co.*, 130 Ill., 268.

Pittsburgh Carbon Co. v. *McMillan*, 119 N. Y., 46.

Emery v. *Candell Co.*, 47 Ohio State, 320–324, N. E. 660.

Mound River Coal Co. v. *Barclay Coal Co.*, 68 Pa. St., 173.

Arnot v. *Coal Co.*, 68 N. Y., 558.

India Bag Association v. *Koch*, 14 La. Ann., 168.

2. Where the corporation was organized to control prices, regulate output, destroy competition and create a monopoly, *and had succeeded in doing so.* The following are such cases:

Distilling and Cattle Feeding Co. v. *People*, 156 Ill., 448.

State v. *Nebraska Distilling Co.*, 29 Neb., 700, 46 N. W., 155.

Richardson v. *Buhl*, 77 Mich., 632, 43 N. W., 1,102.

Before the court can declare the Columbia Straw Paper Company an illegal combination, it must go much further than did these adjudications invoked by appellants.

No case has yet declared that a partnership formed to conduct a certain business is illegal because the respective partners had previously prosecuted independently the same line of business.

No case has held that the purchase by an individual, a firm or a corporation of the stock or plant of another engaged in the same line of business is against public policy or is forbidden by law.

And no court has yet held that the purchase by one of a number of competing plants, and their unification into a single business is, of itself, a violation of the law, especially if the extent of such purchase was so limited that it could not and did not regulate prices, thwart or check competition or approximate to a monopoly.

The Columbia Straw Paper Company was organized in 1892. A corporation known as the "Paper Commission Co." was organized in 1894, for the manufacture and sale of every kind of paper and a large number of other purposes. (Rec., 410.) Appellants urge that some of its directors were directors in the Columbia Straw Paper Company, and that the object of such Paper Commission Company was to regulate prices and prevent competition.

It is not shown that it undertook to accomplish or did effect any such purpose. At any rate its creation was long after the execution of the bonds and mortgage by the Columbia Straw Paper Company, and the bondholders, whose interests are represented by appellees, can not be affected by its purpose or its acts. A corporation

can not escape liability upon its bonds by its subsequent commission of illegal acts.

It may likewise well be argued that whatever may be said as to the legality of the organization of the corporation, its illegality would not affect the validity of the mortgage, a collateral instrument, or enable the corporation and its stockholders to defeat the just claims of its bondholders who are creditors.

The case in this aspect seems to be governed by the principle of a number of well considered authorities.

Sharp v. *Taylor*, 2 Phillips Ch., 801.
McBlair v. *Gibbes*, 17 How., 232.
Brooks v. *Martin*, 2 Wall, 70.
National Distilling Co. v. *Cream City Importing Co.*, 86 Wis., 352-355.
Dennehy v. *McNulta*, 86 Fed. Rep., 825-827.

The main question in this case is, whether there is a liability on the part of the bondholders, as stockholders, which can be set off against the bonds in this proceeding. Respondents deny such liability on the following grounds:

IV.

No rights of creditors are involved in this suit.

Appellants are not creditors, nor do they, or could they, appear on behalf of creditors. No creditor is a party to this proceeding other than the bondholders, who are seeking through the complainant trustees to enforce their mortgage.

Hence, even were it conceded that there was a fraudulent overvaluation of the property acquired by the com-

pany, still we are relieved from the necessity of discussing what rights any *creditor* might have to institute and maintain a proceeding to enforce a liability of stockholders or to intervene in this proceeding.

Appellants intervened solely as minority *stockholders* to defend, on behalf of themselves or of the defendant corporation, against this foreclosure proceeding.

V.

There was, under the contract whereby the company delivered to Stein its stock and bonds in return for the lands described in the option contracts, no fraudulent overvaluation of the properties, and hence all the stock of the company was fully paid.

To establish a fraudulent overvaluation, a *fraudulent intent* must be shown, or a gross and obvious overvaluation must be proved.

> *Coit* v. *Gold Amalgamating Co.*, 119 U. S. 143.

This was an action by a *creditor*. This court sustained a decree dismissing the bill.

It said:

> "If it were proved that actual fraud was committed in the payment of the stock and that the complainant had given credit to the company from a belief that its stock was fully paid, this would undoubtedly be substantial ground for the relief asked. But where the charter authorizes capital stock to be paid in property, and the shareholders honestly and in good faith put in property instead of money in payment of their subscriptions, third parties have no ground of complaint. The case is

very different to that in which subscriptions to stock are payable in cash and where only a part of the installment has been paid. In that case there is still a debt due to the corporation, which, if it becomes insolvent, may be sequestered in equity, by the creditors, as a trust fund for the payment of their debts. But where full-paid stock is issued for property received, there must be actual fraud in the transaction to enable creditors of the corporation to call the stockholders to account. A gross and obvious overvaluation of property would be strong evidence of fraud."

Bank of Fort Madison v. *Alden*, 9 Sup. Ct. R., 332.

In that case a number of persons owning timber land formed a corporation for the manufacture and sale of lumber, and the lands were conveyed to a trustee for the benefit of the corporation according to an agreement by which each member was to receive stock in proportion to his individual interest in the lands, the trustee accepting such lands in full payment of the shares issued. It was held that even a *creditor* of the corporation, having full knowledge of the facts, could not enforce a liability against a stockholder on the ground that the land conveyed by him was worth much less than the stock received therefor, and that therefore he was indebted to the corporation.

The court, Field, J., says:

"The bill was framed upon the theory that the deceased was at the time of his death indebted to the company in a large amount for the stock issued to him, it being contended that the cash value of the lands conveyed to the trustee for that stock did not exceed forty per cent. of the amount subscribed, but this theory falls to the ground before the facts of the case as detailed above. The parties who became stockholders had, pursuant to a previous

agreement, conveyed their lands to a trustee in trust for the corporation formed, upon an understanding that stock should be issued to them in proportion to their individual interests in the property. The subscription was made upon this arrangement and the parties acted with full knowledge of the conditions on which the property was to be transferred to a trustee and the stock was to be issued to them. There was no attempt to pass off the property as different or more valuable than it was. There was no deception or misrepresentation of any kind in the case. No demand therefor against the estate of the deceased Waterman can be sustained upon the assumption that by the conveyance of his land he had not paid up all that he had contracted or was bound to pay by his subscription. There was no credit given by the bank to the company upon the representation of a different set of facts than that which actually existed. The bank was owned by two of the stockholders of the company, Brewster and Smith, who had participated in and had been well advised of all that was done by the company. They held all the shares of the bank and were respectively its president and cashier. Such being the case, the answer to the claims of the bank is found in the decision of this court in

Coit v. *Amalgamating Co.*, 119 U. S. 343."

The court after commenting upon the latter case, say:

"Under this authority no foundation is laid for calling upon the estate of the deceased to pay anything more for the stock issued to him than was paid."

It is well settled that in order to invalidate an issue of stock, which is issued for property taken at an overvaluation, it must be shown not only that there was an overvaluation, but also that such overvaluation was intentional and consequently fraudulent.

1 Cook on Stockholders, Sec. 35.

2 Thompson on Corporations, Secs. 16 and 18 and cases cited.

Gamble v. *Queens County Water Company*, 25 N. E. Rep., 201.

Young v. *Erie Iron Co.*, 31 N. W. Rep., 814.

Bickley v. *Schlag*, 20 Atl., 250.

What the company received for its stock and bonds was not only the individual mill properties, but in addition, was the labor and expense necessary in harmonizing the interests of the mill owners, in procuring the mill plants, and their good-will, and converting them into a single organization. Such a consolidated industry might be vastly more valuable than the aggregate of the prices at which the mill owners were willing to sell their plants. A belief in such greatly enhanced value was the only motive which prompted the mill owners and the other parties engaged in promoting the transaction to endeavor to accomplish it. The owners had a legal right to transfer their properties to the new corporation, not merely at the aggregate of their separate market values, but *plus* all promotion expenses, and the cost and expense attending the entire transaction, and so as to leave a fair profit for themselves, and to those who aided them in promoting the undertaking. They had a right to transfer them on the basis of their probable earning capacity when consolidated into a single organization.

If the earning capacity of the aggregated properties would pay six per cent. on a bonded debt of one million dollars, would retire one hundred thousand dollars of bonds annually, would pay eight per cent. in the preferred stock of one million dollars, and more than five per cent. on the three million dollars of common stock,

or, if the parties engaged in the plan, as reasonable men, honestly believed in such a state of facts, then there was no fraudulent overvaluation. Thse parties represented and were enthusiastic in their opinion (Rec., 588), that as the annual sale of straw paper had been ninety thousand tons a year, and was increasing ten thousand tons per annum, that the company could control a large part of the trade, and could sell that amount, or nearly that amount each year; that as paper had been manufactured at a cost of $18 per ton, the company with increased facilities for economic management by systematizing the purchase of straw, with facilities for making paper, and savings on rent and management, could produce it for $16; that as the average sale price for a term of years had been more than $26, the company could sell for $26 a ton. If the company could manufacture and sell 50,000 tons annually at such rates, it could pay five per cent. on the common stock after paying interest on the bonds, dividends on the preferred stock, and retiring annually $100,000 bonds.

If their beliefs or anticipations were well founded, there was no overvaluation. If they honestly entertained them, there certainly was no fraudulent overvaluation. There is evidence that such were their beliefs. There is no evidence that they did not honestly entertain them; none that in the then condition of affairs they were oversanguine, or that they were not, as intelligent men, justified in their expectations.

Appellants, upon whom rested the burden of proving overvaluation, merely proved the prime cost of the mills and contended that a capitalization beyond such cost was to the extent of such excess, a fraudulent overvaluation. They omitted from consideration all cost of

promotion, the expense of consolidation and reorganization, all the enhanced earning capacity, and hence increased value of the consolidated industry. Practically conceding the good faith of all parties in their belief in the earning capacity of the company, they introducing no evidence tending to show that such belief in the then situation of business was not justified; not denying that they joined in such belief, they still unreasonably insist upon an overvaluation.

Gamble v. *Queens Co. Water Co.*, 123 N. Y., 91; 25 N. E. Rep., 201.

In the above case it was held that the true inquiry in determining whether or not the price paid by a majority of the stockholders of a corporation for property was so excessive as to be a fraud on the minority was what, under all the circumstances, was a fair value of the property to the company, considering its proposed use and the general purpose for which the company was organized. In determining this question, where the property had been conveyed by the company to a director, and a minority of the stockholders were seeking to have the conveyance set aside as having been conveyed at a fraudulent overvaluation, it was held proper to take into consideration the value of the time, interest on the money which the director had expended thereon, and to this might be added its cost, and he might in addition be allowed a fair profit thereon and whatever advantage he might have gained on the price of the materials used; that an order by a majority of the stockholders of a corporation to pay an excessive sum for property purchased by it in stock and bonds was not to be condemned as fraud, unless the majority acted in bad faith, on which

question the probable or presumptive value of the property might be considered.

Where the owners of properties arrange to convey them to a corporation to be formed, there is no fraud whatever in capitalizing the corporation upon the basis of the earning capacity of the consolidated properties, irrespective of the aggregate of the sums at which the individual properties could be purchased.

Nor is the fact that the parties were disappointed in their expectations at all conclusive of the unreasonableness of their belief.

That the financial depression of 1893 would occur soon after organization and would almost extinguish the demand for straw paper and send the selling price below the cost of production, was no more to be foreseen and counted upon by those connected with this undertaking, than by the thousands of persons and corporations throughout the country engaged in other industries and enterprises which were wrecked in the same panic.

The property is not to be considered as over-valued merely because subsequently it turns out to be so. The various circumstances under which the valuation was made should be considered in determining the *bona fides* of the transaction.

1 Cook on Stockholder, Sec. 35.

In *Coit* v. *N. C. Gold Amalgamating Co.*, 14 Fed. Rep., 12, the court said :

> "Corporators ought not to be made liable individually for the debts of the company at the instance of creditors because at a later date the estimate fairly put upon the property at that time, has become modified by subsequent events and will not amount to the value which they set upon it."

On appeal this court in affirming the judgment below, 119 U. S., 343, said:

> "Where full-paid stock is issued for property received, there must be actual fraud in the transaction to enable creditors of the corporation to call the stockholders to account."

In *Carr* v. *LeFevre*, 27 Pa. St., 113, the court said that:

> "If the directors took lands at a prospective value never realized, it is nothing more than many individuals and corporations have done before. Such an error in management or in their judgment of the value of a purchase made without fraud affords no ground for rescinding the contract."

Where a mine is turned in at a large valuation for stock no fraud is proved by the mere fact that the mine subsequently turned out not to have been worth over one-fifth of that amount. Fraud exists only when intentional overvaluation, or such a reckless conduct in the placing of its value without regard to its real worth as would indicate without explanation an intent to defraud.

Young v. *Erie Iron Co.*, 31 N. W. Rep., 814.

In determining whether the company issued its stock for less than its par value, the contract providing for such issue and the acts of the company thereunder must be judged as of the time when the contract was made and the stock was issued, the "value" of the property transferred contemplated by the act being its value at the time of the transaction.

Huntington v. *Attrill*, 118 N. Y., 355.
Prospect Park R. R. Co. v. *Coney Island R. R. Co.*, 144 N. Y., 163.

At the time when the contract between Stein and the

company was entered into, there is no doubt that all parties justly believed that the property transferred was fairly worth the amount of stock and bonds issued therefor. What Stein agreed to pay for it was no measure of its value. Such value was enhanced by the fact that he had not a single plant, but a large number of plants which could be operated economically and profitably. The statistics of the business, the data which were conceded by all who had any knowledge of the industry, seemed to establish to a demonstration the fact that the earning capacity of the property which Stein controlled was such as to insure the conservativeness of the valuation which he placed on the property and which the company agreed to pay. Subsequent events, which could not have been anticipated, a rival product theretofore unknown, a financial panic of a most disastrous character, a series of disappointments, the curtailment of the market, prevented the realization of the just expectations of all concerned, but that fact in no manner affects the *bona fides* of the capitalization of the company, or warrants a rejection of the findings of fact which have been approved by the courts below.

Stein asserted that the property which he controlled was equal in value to the par value of the bonds and stock received therefor, and it is not likely that the company consented to pay him more than it considered it reasonably worth.

As was said by Mr. Justice HAIGHT in *VanFleet* v. *Jones*, 75 Hun., 340:

> "It is natural that the owners of property taken by a corporation of which they are stockholders, and in payment for which stock of the company is to be issued, should desire to realize for their property all that it is worth, and the statute is not violated with

> respect to the issuance of stock in payment for property unless such persons in bad faith put a fictitious value upon their property for the purpose of evading the statute and defrauding others."

There is an unbroken line of authorities in support of the proposition that, even as to creditors, where stock has been issued for property in good faith to an amount which the directors believed to represent its actual value, the provisions of a statute similar to that of New Jersey, under which this stock was issued, will not be deemed to have been violated, even although it eventually develops that the property was worth much less than was supposed, or even where it turned out to be of no value whatever.

In *Schenck* v. *Andrews*, 57 N. Y., 133, it was held that mere mistake or error of judgment by trustees, either as to the necessity of the purchase or as to the value of the property purchased, for which stock is issued, if made in good faith and not in evasion of the provisions of the act, will not subject the holder of stock issued in payment for property purchased to liability for the debts of the corporation.

LOTT, Ch. C., said:

> "There are many circumstances that affect values. The time of the purchase, the demand for the article sought for, a limited supply, the credit given, a panic in the money market, and various other matters have their influence and effect, and which cannot be properly appreciated at a remote day after these causes have ceased to operate. An illustration may be given by reference to the difference in the prices of articles needed in the late war and the present time. Indeed, our experience shows that the prices are more or less fluctuating, even at short intervals of time, and different juries would be very

> likely to disagree on the same evidence as to the value of an article on a specified day two or three years previous to the time they were called to pass on the question. * * *
>
> "Every person who deals with it (the corporation) has the means of ascertaining whether its capital has been paid in money or in property, and he is under no obligation to sell it any goods if he finds that it, or any portion thereof, has been paid in property. Due prudence and care on his part will enable him to ascertain its nature and value, and if he should be induced to hazard a sale of goods on credit, instead of money paid down, by high profits, he has no right to ask a court for relief from the consequence of his avarice or folly in making a sale, without payment at the time of the price agreed upon."

The statute gives the trustees discretion, and they are to be the judges, both as to the necessity for and the value of the property. Good faith and the exercise of proper discretion and honest judgment is all that is required.

REYNOLDS, C., said:

> "I entirely agree that if the promotors of a corporation of this character shall, with a view to defraud, fill up the capital stock by putting in property at grossly exorbitant values, they are not to be exempted from the personal liability imposed by the statute. In such cases they ought to respond in damages to the extent of the wrong they design to accomplish. But, if in the furtherance of an honest purpose, they fall into an error of judgment in placing a pecuniary value upon property supposed to be needful for the success of the enterprise, I think a different ruling should prevail. And I think it need only be suggested in support of this position that upon the question of the value of property, and more especially that adapted to mining, mechanical and manufacturing purposes, a very wide difference

> of opinion may honestly exist among the most intelligent of men familiar with such operations. There is no exact mathematical value which can be applied to mines or minerals in the bowels of the earth, or to mechanical contrivances or manufacturing establishments, when their development is sought for by associated wealth. It is matter of honest observation that the most intelligent and conscientious of men upon such questions entertain widely different opinions; and it would be a fatal blow aimed at every such enterprise if those who honestly risk their capital in such enterprises shall be held as guarantors to all creditors for its eventual success."

In *Boynton* v. *Andrews*, 63 N. Y., 93, the last case cited was approved, and Judge MILLER said:

> "The words 'value thereof' evidently mean a fair valuation of the property, considering the purposes for which it is to be used, the nature of the business for which it is purchased, and for the prosecution of which the corporation is organized. This rule authorizes an extended and wide latitude in the determination of the question of value. While certain kinds of property which are employed for manufacturing purposes, such as machinery, fixtures, etc., have a specific and definite value which is readily ascertained and fixed, there are other descriptions of property where the value is dependent upon circumstances which render it quite uncertain and frequently very difficult to decide what the real, fair and just value of the same actually is. Mines and mining lands may properly be considered as embraced in the latter class, as their intrinsic value is fluctuating and uncertain, and depends to a very great degree upon their successful development. It, therefore, may well be that an honest over-valuation might be made of property of this kind or agreed upon, without a semblance of intentional fraud. So, also, an error in judgment, or a mistake in placing a valuation on property appropriated as capital by a manufacturing company, if made in good faith and not to evade the provis-

> ions of the act in question, would not of itself subject the owner of stock issued in payment of the property issued to personal liability. * * * A discrepancy in the opinions of witnesses upon the question of values can not be considered as sufficient to establish fraud so as to render the stockholder individually liable."

In *Douglas* v. *Ireland*, 73 N. Y., 100, the rule as laid down in the preceding cases was approved, and it was held that, to establish fraud which would take stock issued for property out of the purview of the statute it was necessary to prove: 1. That the stock exceeded in amount the value of the property in exchange for which it was issued. 2. That the trustees of the corporation so issued it deliberately, and with knowledge of the real value of the property.

In *Lake Superior Iron Co.* v. *Drexel*, 90 New York, 87, a corporation was organized with a nominal capital of $2,500,000. A proposition was made to its board of trustees to sell to it certain patents and properties for $2,500,000, and to receive in payment the whole of the capital stock, the vendors, however, to deliver $900,000 of the stock to the trustees, $600,000 thereof to be sold at fifty per cent. of its par value, $50,000 of the purchase price to be paid to the vendors, and the balance to be paid over to the treasury of the company for its use. This proposition was accepted and carried out. The defendants subscribed and paid for five hundred shares of the stock at fifty dollars per share. In an action brought for the company's debts several trustees testified that they acted in good faith in the transaction, and believed the property purchased to be worth $2,500,000. The verdict of the jury, to the effect that the purchase and issue of the stock was in good faith, was sustained.

In *Skinner* v. *Smith*, 134 N. Y., 240, the original capital stock of the company was $40,000, and was issued to the defendants, the owners of certain letters patent relating to the manufacturing of carpets by machinery in consideration of a license for the use of the invention. Subsequently the license was reconveyed to the defendants, who surrendered the stock issued therefor. The stock of the company was then increased to $600,000, all of which was issued to the defendants, they paying therefor $250,000 in cash, and for the residue granted to the corporation a license to manufacture under the patent on payment of a specified royalty. This transaction was found by the court to have been in good faith, and with no intent to defraud any future holder of the stock, and was, therefore, legal.

The case of *Lorillard* v. *Clyde*, 86 N. Y., 384, involved the validity of an agreement between competitors in the transportation business by water for the formation of a corporation with a capital of $300,000, to be represented by the property of the two contracting parties. It was claimed that the agreement was illegal, because it was provided that the property should be taken to represent the whole of the capital at the valuation fixed by the parties. Judge ANDREWS, however, said:

> "We have not been referred to any statute which prohibits the organization of a corporation of the character of the one contemplated by this agreement on the basis of chattel property contributed by the corporators. It cannot be assumed that the transaction was not *bona fide*, or that the valuation on the vessels was fictitious or extravagant. The value of the stock would depend upon the value of the *property and business*.
>
> "The parties fixing the valuation were the only

parties interested, and we know of no principle of public policy which condemns an agreement between parties about to form a corporation, because by the arrangement the capital stock is to be represented by property which they severally contribute, at a valuation agreed upon between themselves."

In *Stewart* v. *St. Louis R. R. Co.*, 41 Fed. R. (Neb.), 736, where a railroad road-bed worth $2,000 was turned out to a corporation for $200,000 of its notes and $3,600,000 of its stock, it was held that the notes could be collected.

In *Northwestern Mutual Life Ins. Co.* v. *Cotton Exchange*, 75 Fed. R., 155, it was held that a purchaser of stock in a Missouri business corporation may pay therefor in real estate, subject always to the scrutiny of the courts into the honesty of the value placed upon real estate. If this value be fixed in good faith, although it should subsequently transpire to be greatly excessive, the courts will not disturb the arrangement.. There a building company having invested $88,000 in a building, sold it to a new corporation for $125,000 stock and $75,000 in bonds. The property brought $50,000 on a subsequent foreclosure, and creditors sought to enforce a stockholders, liability and failed. Mr. Justice PHILLIPS said:

> "Good faith and honesty of purpose are the tests. If the real estate transferred for the stock in the new corporation was honestly believed by the parties to the transaction, to be equivalent in value to the face of the stock issued, a creditor of the corporation may not assail the transaction, although it should subsequently transpire that the property in fact was overvalued."

Even the authorities which are sometimes cited to sustain a stock liability toward *creditors* on the ground of

the *mala fides* of a stock issue, do not affect our position, but, on the contrary, sustain it.

We refer to

> *Huntington* v. *Attrill*, 118 N. Y., 365.
>
> *National Tube Works Co.* v. *Gilfillan*, 124 N. Y., 302.

In *Huntington* v. *Attrill* (*supra*), the statute under which the corporation was formed differed in phraseology from that applicable here. It prohibited the issuing of stock for property, except for "property actually received for the use and legitimate purpose of said corporation at its fair value." The action was brought against the defendant as a director to enforce liability for a debt of the corporation, because of the signing of a false certificate. The alleged false representation was that the whole capital stock, amounting to $700,000, had been fully paid in. All of the stock was issued to the defendant in payment for 120 acres of land on the seashore, which he conveyed to the corporation subject to a mortgage of $72,000, the payment of which was assumed by the company. This land was part of 140 acres purchased by the defendant six months before the organization of the company, and in contemplation thereof, for $80,000, of which he paid $8,000, and gave the mortgage for $72,000, which was afterwards assumed by the corporation to secure the balance. His total cash investment, therefore, was $8,000, for which he retained 20 acres of land, and received $700,000 in stock. The land had no known market value at that time, or any intrinsic value of large amount. Extensive improvements were made upon the property, which was afterwards sold at a judicial sale for $175,000, after the

corporation had incurred liabilities to the amount of $994,000. Within four months after the formation of the corporation it was in the hands of a receiver. The court, nevertheless, charged the jury that *they had the right to consider, in determining the fair value of the property, its value for the use to which it was to be put, and the adaptability of it to any specific purpose;* that these were constituent elements of intrinsic value, and, although the value to be ascertained by the jury was that, at the time of the sale and conveyance of the company, any peculiar advantages known or unknown, which, even if known, would make it advantageous to a few only, properly enter into consideration, and go to make up the value as of that time.

Judge BRADLEY approved of this charge and said:

> "The fair value contemplated by the statute is that which the property had at the time of the sale, and which constituted the consideration upon which the subscription to the capital stock of the company was satisfied. Then was the time the estimate of the value must for that purpose be deemed to have been made. It could not be dependent upon subsequent successes or failure of the investment further than such result may have been legitimately within evidential contemplation at the time of the sale in view of the uses for which it may have had available advantages within itself."

The property for which the stock was in that case issued had no established earning capacity, was a barren stretch of sand, distant from all habitations, represented practically no investment whatever on the part of the individual to whom the entire capital stock was issued for a shadowy equity.

In *National Tube Works Company* v. *Gilfillan* (*supra*) the corporation issued $300,000 of stock for the transfer

of a lot of unpatented inventions to one Bliven. Two corporations had been previously organized with the defendant as a trustee in each to handle these inventions. One had merely a paper existence, the other was a disastrous speculation, and the third corporation became hopelessly insolvent in less than a year after its organization. Immediately upon the formation of the corporation $100,000 of the stock was surrendered to the corporation, $50,000 were received by the defendant in payment of a debt of $15,000 owing to him by Bliven, $5,000 were transferred in payment of another debt of Bliven amounting to $2,500, and $13,500 of stock was given away to qualify trustees and to induce them to act. The arrangement to thus dispose of the stock was made before the purchase by the corporation and was part of the transaction. The facts were known to all of the trustees. The court very properly inquired why, if these inventions were worth $300,000, so large a proportion of the stock was given away for so small a consideration. The views of the court on the legal aspects of the case are presented by the following opening sentences of Judge VANN's opinion:

> "The substantial issue in the action was whether the property procured in exchange for the stock was purchased at an overvaluation, not through error of judgment, but in bad faith and to evade the statute. The trial judge instructed the jury that if they found that the stock issued exceeded in amount the value of the property taken in exchange for it, and for which it was issued, and that the trustees deliberately and with knowledge of the real value of the property overvalued it and paid in stock for it an amount which they knew was in excess of its actual value, they must find for the plaintiff. If the jury do not find this to be the fact then they will find for the defendant."

In *Grant* v. *East & West R. R. Co. of Alabama*, 54 Fed. Rep., 569, it was held that the constitutional provisions in Alabama, forbidding the issue of stock or bonds except for value, and the statutory provisions requiring subscriptions to railroad stock to be paid in money, labor or property at their money value, does not prevent one railroad company from selling its property to another company for the bonds and stock of the later, and that the valuation placed upon the property might be *its net earning power*, and the cost of rebuilding it, irrespective of the original cost.

In *Commonwealth* v. *Central Passenger R. R.*, 52 Pa. State, 506, 515, passing upon the legality of an issue of $500,000 of stock for a road that had just been sold under a mortgage for $100,000, the court said:

> "In all such cases the determination of the amount of stock must be an arbitrary adjustment. As we have stated, the cost of the property is no fair measure of what the stock represents; and if the real value be adopted as the standard, it is no standard at all. It varies with the estimates of witnesses, and the franchises are incapable of valuation. * * * If that was a sum greater than the actual value of the company's franchises and property, as it was greater than the cost, we are unable to see how the public was affected by the exaggerated estimate."

Carr v. *LeFevre*, 27 Pa. State, 413.
Fogg v. *Blair*, 139 U. S., 118.
Clark v. *Bever*, 139 U. S., 96.
Handley v. *Stutz*, 139 U. S., 417.
Danville R. R. Co. v. *Kase*, 39 Atl. Rep., 301.

Many additional cases might be cited to the foregoing effect, but it seems unnecessary to do so in view of the fact that there is not a particle of evidence presented im-

pugning the good faith of the directors of the corporation in issuing its stock or indicating that the property for which the stock was issued, was not fairly worth, or, at least honestly believed to be worth the par value of the stock.

Were this an action brought by creditors to establish the liability of stockholders of the company on the theory urged, it would be incumbent upon them to prove affirmatively, every fact and circumstance on which the right to recover depends. Nothing would be presumed. The burden of proof would rest upon them.

Whitney Arms Company v. *Barton*, 63 N. Y., 62.

Van Dyck v. *McQuade*, 86 N. Y., 38.

Whitney v. *Cammann*, 137 N. Y., 344.

"It will be observed that the transactions which are to be investigated to enable the plaintiff to establish these facts must have taken place at the time when the property was bought, and stock issued in payment for it, and the *creditor is bound to establish that at that time there was an overvaluation to the knowledge of the trustees*, by which the assets of the company were deliberately sacrificed. It follows that the evidence must be directed to the occurences of that time, for those occurrences are the ones to be explained. *The plaintiff must show the value of the property at that time, and he must also show by competent evidence that the trustees, knowing the actual value, intentionally overvalued it and issued stock for it at the overvaluation.*"

RUMSEY, J., in *White* v. *Jones*, 86 Hun., 59.

Petitioners have dismally failed in sustaining this burden. On the other hand, it has been shown that no stock was issued except after a most careful consideration of the earning power of the plants acquired. It was

this earning capacity on which the greatest stress was laid. It was deemed to be the most important element of value. Here were thirty-nine established plants, each being a going concern, each having a valuable good-will attached to it, and each having not only the potentiality, but on the basis of known facts what seemed to be a certainty of realizing a profit which rendered the valuation placed upon the property extremely reasonable. To apply to this situation any *post hoc* argument, is to ignore the elementary laws of trade and the universal basis on which business operations rest.

It was said by Mr. Justice BREWER, in *Monongahela Co.* v. *U. S.*, 148 U. S., 328:

> "The value of the property generally speaking, is determined by its productiveness, the profits which its use brings to its owners. Various elements enter into the matter of value."

See, also, *Washburn* v. *National Wall Paper Company*, 81 Fed. Rep., 17.

There being then no fraudulent overvaluation of the properties, the stock which Stein received was in fact and in law, as it purported to be, full paid and non-assessable. Being so full paid in his hands, it continued so to be in the hands of whoever received it from him, whether mill vendor, bondholder or other person.

The claim of appellants, that a stock liability on the part of bondholders should be set off against the bonds does not concern Stein, as he is not a bondholder. (Rec., 147, 347, *et seq.*) The bondholders represented by complainants below are here asserting that the stock which Stein received was fully paid, because if it be true, then all their stock was also full paid stock, since they received it from him.

VI.

The defendant corporation could not maintain an action or defense such as was set up by appellants.

In this case there was no stock subscription, and the only agreement between Stein and the company was that the company should convey to him its full paid stock and bonds, and that he should convey to the company the mill properties described in the option contracts and pay it $250,000. The contract was fully executed by both parties. Either that contract is binding, which is the end of the matter, or it is voidable. In the latter case, it might have been promptly rescinded in an appropriate proceeding. If rescinded, the contract relations between the parties would end. Each must return to the other what he had received. If enforced, it must be enforced as made. It is an entirety. It cannot be enforced in part and rescinded in part. Neither a party or a court can substitute another contract in place of that actually made. If the corporation should desire and is entitled to rescind, it must return to Stein the thirty-nine mill plants and $250,000. Stein must then return the stock or must pay its amount or value. But the *corporation* cannot say to Stein, "I will keep your property and your money, and you must pay what you never agreed to pay except in the manner you did pay."

When one subscribes for a certain amount of stock, and that must be paid for in money, or "money's worth" under a statute, the subscriber is bound by the contract, and it can be enforced against him. A subsequent contract that something else than the statute and the subscription contract called for shall discharge his former

contract is void, certainly as to creditors. But where there is but a single contract, and that is that the party will convey certain property in exchange for so much stock, as is the case here, that contract cannot be partly enforced and in part avoided by a party thereto. The corporation cannot enforce so much as is for its benefit and rescind so much as is opposed to its interests. This is fully sustained by the adjudications.

In 1 Cook on Corporations, Sec. 47, it is said:

> "Many attempts have been made in cases where stocks were issued for property taken at an overvaluation, to hold the party receiving such stock liable for its full par value less the actual value of the property received from him. These attempts have not been successful, as already seen. The transaction is upheld as legal and valid and binding on all parties unless there is an overvaluation, and that overvaluation is shown to have been fraudulent. When this is proved, then the contract is to be treated like other fraudulent contracts. It is to be adopted *in toto* or rescinded *in toto*, and set aside. Both parties are to be restored as nearly as possible to their original positions. The property, or its value, is to be returned to the person receiving the stock, and he must return the stock or its real value."

It is also said (Sec. 38):

> "The corporation itself, after issuing its stock as paid-up stock and declaring it so to be, cannot subsequently repudiate that declaration and agreement and proceed to collect either from the person receiving the stock, or his transferee, the unpaid part of the par value. It is estopped from so doing.
>
> Where, however, actual fraud enters into the transaction, then the corporation is not estopped from having the agreement set aside. *The person receiving the stock can then be compelled to return the stock or its market value, and take back that which he gave to the corporation for it, but the cor-*

poration cannot hold him liable for the par value of the stock."

In *Scoville* v. *Thayer*, 105 U. S., 143, the court said:

"The stock held by the defendant was evidenced by a certificate of full-paid shares. It is conceded to have been a contract between him and the company, that he should never be called upon to pay any further assessments upon it. The same contract was made with all the other shareholders, and the fact was known to all. As between them and the company it was a perfectly valid agreement. It was not forbidden by the charter or by any law of public policy, and as between the company and the stockholders was just as binding as if it had been expressly authorized by the charter.

If the company, for the purpose of increasing its business, had called upon the stockholders to pay up that part of their stock which had been satisfied 'by discount,' according to their contract, they could have successfully resisted such a demand. No suit could have been maintained by the company to collect the unpaid stock for such a purpose. The shares were issued as full paid on a fair understanding, and they bound the company.

In fact, it has been held in recent English cases that not only is the company, but its creditors also, are bound by such a contract.

But the doctrine of this court is, that such a contract, though binding on the company, is a fraud in law on its creditors, which they can set aside; that when their rights intervene and their claims are to be satisfied, the stockholders can be required to pay their stock in full.

The reason is, that the stock subscribed is considered in equity as a trust fund for the payment of creditors. * * * Considered in the view of a Court of Equity, the contract between the company and its stockholders was this, namely, that the stockholders should pay, say for example, $20 per share on their stock, and no more unless it became neces-

sary to pay more to satisfy the creditors of the company, and when the necessity arose and the amount required was ascertained, then to make such additional payment on the stock as the satisfaction of the claims of creditors required.

When the company was adjudicated bankrupt the assignees were bound by this contract. Thus equitably construed their duty was to collect a sufficient sum upon the unpaid stock which, with the other assets of the company, would be sufficient to satisfy the company's creditors. They were authorized to collect no more. If it should turn out that the other assets were sufficient, no action would lie against the stockholder for the balance due on his stock, for if in a bankrupt proceeding any surplus remained after payment of debts, it would go to the company and not to the stockholders, and we have seen that the company in this case would have no right to any surplus. * * *

In this case there was no obligation resting on the stockholder to pay at all until some authorized demand in favor of the creditors was made for payment. He owed the creditors nothing, and he owed the company nothing save such unpaid portion of his stock as might be necessary to satisfy the claims of the creditors. Upon the bankruptcy of the company his obligation was to pay to the assignees upon demand such an amount upon his unpaid stock as would be sufficient, with the other assets of the company, to pay its debts. He was under no obligation to pay any more, and he was under no obligation to pay anything, until the amount necessary for him to pay was at least approximately ascertained.

But not only was it necessary that the amount required to satisfy the creditors should be ascertained, but that the agreement between the company and the stockholders to the effect that the latter should not be required to make any further payments on his stock should be set aside as in fraud to the creditors. No action at law would lie to recover the unpaid balance due on the stock until this was done.

* * * In the present case there was, as between the company and its stockholders, no obligation on the part of the latter to pay the residue of their stock unless it became necessary to satisfy creditors."

Foreman v. *Bigelow*, 4 Clifford, 508.

Here a mining corporation bought certain mineral lands and paid for the same in shares of stock, which were issued to the directors as paid-up stock. The lands were greatly overvalued. The corporation went into bankruptcy, and suits were brought by the assignee to recover the difference between the real value of the lands and the par value of the stock. Justice CLIFFORD said:

"Fraud does not render a contract void, but voidable only at the option of the party defrauded, both at law and in equity, whether the fraud was committed by one of the contracting parties upon the other, or by both upon persons not parties to the transaction, the rule being that where the fraud was committed by one of the parties upon the other, the contract remains operative and in force until it is disaffirmed by the injured party. * * * The bill of complaint seeks to enforce by respondents the payment of the entire capital stock of the company, or such portion of the same as may be necessary to pay the debts of the corporation, less the amount any particular holder of stock may have paid towards his shares. Three classes of shares were issued, as plainly appears from the allegations of the bill of complaint. 1. Shares to the amount of $350,-790 fraudulently issued to the directors in payment for the mining lands which they, at a greatly overvalued estimation, conveyed to the corporation. * * * Issued as these shares were to the directors in payment for the mining lands they were as between the grantors of the land and the directors issuing the shares fully paid up, as the shares paid for the land and the land conveyed paid for the shares, and all this appears from the books of the company. * * *

The complainant contends that such payment was made in mineral lands of a fraudulent valuation, not binding on the corporation. Admit that and still the fact remains that the land was actually received by the company in full payment for the stock, and that the shares were issued and delivered as fully paid up shares. Taken as a whole, the averments of the bill of complaint show that the transaction in purchasing the mineral land and in issuing the first class of stock in payment for the same, was a gross fraud upon the company which cannot be sustained; but it does not follow that the present suit against the respondents is a proper remedy to redress the injury, for the reason that the contract was duly executed by the execution of the deed of conveyance to the corporation, and by the issue of fully paid up shares by the corporation, for the whole amount of the agreed consideration of the mineral land.

Nothing can be plainer in legal decision than that the title to the mineral land passed to the corporation and that the title to the paid up stock passed to the directors. If formally executed the contract must stand until it shall be rescinded or the assignee, if he prefers that course, may retain what the company received for the stock and seek redress in damages against those who defrauded the corporation. And the redress is at his command, but he certainly cannot be allowed to disaffirm the contract only in part and affirm it as to the residue, as he must in order to maintain the present suit against the respondents. * * * Where there is a contract, even if fraud be imputed, the parties seeking redress must disaffirm the contract or proceed for damages against the perpetrators of the fraud. Such a party must throw over the agreement altogether, or he must take it as a whole. He cannot adopt it as to one part and reject it as to the residue."

Brandt v. *Ehlen*, 59 Md., 1.

In that case Mr. Justice Wood, delivering the opinion of the court, said (pages 153–4):

"The stock held by the defendant was evidenced by certificates of full-paid shares. It is conceded to have been a contract between him and the company that he should never be called upon to pay any further assessments upon it. The same contract was made with the other shareholders, and the fact was known to all. As between them and the company this was a perfectly valid agreement. It was not forbidden by the charter or by any law of public policy, and as between the company and the stockholders was just as binding as if it had been expressly authorized by the charter. If the company, for the purpose of increasing its business, had called upon the stockholders to pay up that part of their stock which had been satisfied by discount according to their contract, they could have successfully resisted such a demand. No action could have been maintained by the company to collect the unpaid stock for such a purpose. The shares were issued as full paid on a fair understanding, and they bound the company."

Phelan v. *Hazard*, 5 Dillon, 43-52.

In the above case Judge Dillon, in giving the opinion of the court, after commenting on cases where it was plain that the stock had been issued by the company for property of less value than the par value of the stock, said:

"The proofs show that the shares in question had been paid for precisely as they were originally agreed to be paid for, viz: by the conveyance of the mining property to the corporation. This conveyance had been received and recorded by the corporation. Unless this agreement is rescinded or set aside for fraud, how can it be said that the stock has not been paid for? The parties have agreed that it has been paid for, and that agreement is conclusive unless it is rescinded or impeached for fraud, and this can not be done unless the attack is directly made.

"The authorities establish that such a transaction is not *ultra vires*, and absolutely void. Second;

that the contract is valid and binding upon the corporation and the original share-takers, unless it is rescinded and set aside for fraud, and that where a contract stands unimpeached the court, even where the rights of creditors are involved, will treat that as a payment which the parties have agreed should be payment."

Coffin v. *Ramsdell* (Sup. Ct., Ind.), 11 N. E. Rep., 20.

This was an action by a receiver, on behalf of creditors, to collect, as unpaid subcriptions, the difference between what was claimed to be the actual value of property given by certain subscribers and received by the corporation in payment of their subscriptions, and the amount of the subscriptions, where there had been an over-valuation of property. It was contended that through such over-valuation the defendant was indebted for at least seventy-five per cent. of the stock subscription.

The court said:

"It is fairly inferable from the facts disclosed that at or subsequent to the incorporation of the company it was agreed between the directors of the corporation and the defendant that his interest in the property and assets of the firm of Unthank & Coffin should be transferred and accepted in full payment of his subscription to the stock of the Unthank Plow Company, and that it was so transferred and accepted. The *gravamen* of the plaintiff's case is, that because there was an over-valuation of the property the transfer and acceptance constituted as against subsequent creditors of the corporation payment *pro tanto* only. Assuming as receiver to represent the creditors of the corporation, the plaintiff in his official or representative character asserts the right to ascertain the real value of the property and assets transferred, and to recover from the defend-

ant the difference between such value and the amount subscribed by him as unpaid subscription.

It is to be noted that there is an entire absence of any charge or suggestion that the corporation was in any way misled or overreached by the defendant as to the situation or value of the property, nor does it appear that the transaction was merely colorable or a mere device on the part of the incorporators to absorb the capital stock of the corporation without making what was regarded and agreed upon as an equivalent in payment. The inference is that the Board of Directors, comprising all the stockholders, with full knowledge of all the facts, accepted the property and assets in question as payment, and without any fraudulent intent, consummated the transaction which stood without question until it was assailed by the receiver in the manner stated. It is to be observed, further, that this is not a suit to rescind or set aside the transfer and acceptance of the property, or any part of it, as fraudulent, nor is there any pretense that the transaction was *ultra vires* and void. From the frame of the complaint, and in all its distinctive features, the action is purely a suit at law to collect unpaid subscriptions to stock. Accepting the situation of the property as he found it, the receiver simply says that the only payment or pretense of payment which the defendant ever made of his subscription was in the manner stated, and that because the property taken in payment was knowingly overreached by the defendant and the other corporators, the difference between the actual value of the property and assets so taken and the amount of the defendant's subscription, remains unpaid * * * Does the fact that the property was received at an overvaluation enable the receiver to maintain his suit without impeaching or setting the transaction aside, if it can be set aside? No proposition can be plainer upon the facts as stated, than that the title to the property and assets which were transferred to the corporation passed to and remains in it, or in the receiver, and that the title of ownership of the stock thereby paid for vested in

the defendant. The transaction having been, so far as it appears, fully executed years before the receiver was appointed, may he permit it to stand, and now treat it as so far void as to ask for a new valution of the property? May he disaffirm the contract in part and affirm as to the residue? We have been unable to discover any principle or well considered authority which affirms this proposition.

The principle deducible from the authorities already cited is, that even in case of an overvaluation of property transferred to the corporation in payment of shares, the transaction unless void for some reason, is binding so long as it is not impeached by the corporation or its assignee, and it can be impeached only for fraud upon the corporation. *Coit* v. *Gold Amalgamating Co.*, 119 U. S., 343; *Phelan* v. *Hazard*, 5 Dillon, 45; *Brant* v. *Ehlen*, 59 Md., 1. * * * A standard author concludes a careful and exhaustive examination of this subject thus: 'The whole discussion resolves itself into the following conclusions: A corporation may take in payment of its shares any property which it may lawfully purchase. Such a transaction is not *ultra vires* or void, but is valid and binding upon the original share takers and upon the corporation, unless it is rescinded and set aside for fraud. While such a contract stands unimpeached, the courts, even while the rights of creditors are involved, will treat that as payment which the parties agreed should be payment.' Thompson Liab. Stockholders, Sec. 134.

The contract not being void must be disaffirmed and set aside before the receiver can maintain an action at law as for unpaid subscriptions. * * * Patent rights and mining and manufacturing property which is embarked in enterprises is frequently valued by their owners and others at a prospective value which may or may not be realized, depending upon future contingencies. If the owners who put such values upon it act in good faith, and yet suffre disappointment, we can see no reason why they should suffer further unless they have been guilty of

fraud or concealment which has resulted in damage to others."

To the like effect are the following cases:

First Natl. Bank v. *Guston*, 42 Minn., 327.

Krohn v. *Williamson*, 62 Fed. Rep., 869.

Wiliamson v. *Krohn*, 66 Fed. Rep., 655.

Wells v. *Green Bay Co.*, 90 Wis., 442.

Proctor Land Co. v. *Cooke*, (Ky.), 44 S. W. R., 391.

Granite Roofing Co. v. *Michael*, 54 Md., 65.

Re Ambrose, Lake Co., L. R., 14 Ch. Div., 390.

St. Louis R. R. Co. v. *Tiernan*, 37 Kan., 606.

Counsel for appellants ignore the distinction made in *Scoville* v. *Thayer, supra*, between actions by or on behalf of creditors and actions by the corporation or its stockholders. The following and other cases cited for appellants are cases in which the rights of creditors were asserted. They have no application in this case.

Lloyd v. *Preston*, 146 U. S., 630.

Webster v. *Upton*, 91 U. S., 65.

Patterson v. *Linde*, 106 U. S., 519.

Upton v. *Tribilcock*, 91 U. S., 44.

In re Hippenheimer, 36 Atl. Rep., 966.

Hebbard v. *Southwestern L. & C. Co.*, 36 Atl. Rep., 122.

In *Hebbard* v. *Southwestern L. & C. Co., supra*, the court recognizes and asserts the distinction made in *Scoville* v. *Thayer*. It says:

"As to the bonus stock, a contract between the purchaser of bonds and the company was that he should not be called upon to pay for the stock.

Such a contract is binding upon the company and its shareholders. But as the capital stock constitutes a trust fund for the payment of debts, it cannot be given away from the demands of *creditors*, and hence the holders of the bonus stock may be required to pay for it in satisfaction of their demands."

Dupont v. *Tilden*, 42 Fed. Rep., 87.

The corporation was authorized by its charter to buy land and pay for it in full-paid stock. It issued such stock in payment for the land to an amount greatly in excess of the value of the land, and the stock was sold to a purchaser for value. Held, that such purchaser was not liable to the creditors of the corporation on the ground that the stock was not fully paid for where there was no fraud in the original transaction, and the corporation has taken no steps to rescind it.

The court said:

"I think there can be no doubt from the proof in this case that the Coal Company agreed to give Taylor 7,000 shares of its stock for land which he conveyed to it. The question therefore arises, does the fact that complainant's testimony shows, or tends to show that this land was not worth in cash over $150,000 at the time it was conveyed to the Coal Company, establish any liability as against these stockholders. There being no proof in the record aside from the resolution of the 18th of May, 1866, and the deed, of the negotiations and dealings between Taylor and the company, or of the circumstances surrounding the transaction leading up to it, I shall assume it as the only natural conclusion from the proof that Taylor offered to sell these lands to the company for 7,000 shares of its stock, and the company accepted the proposition. Taylor made the deed of the land to the company and the company issued to him the stock, or at least issued the shares now held by the defendant.

> The question then arises, could the company have sued Taylor and recovered the difference between the cash value of this land and the par of its stock without first rescinding this contract, even if the land was not worth the par value of its stock? This question I think must upon reason and authority, be answered in the negative."

The court, after citing authorities, further said:

> "It may, I think, be assumed as probable that the 7,000 shares of the stock of this Coal Company, issued to Taylor, were not worth in cash more than the land conveyed by Taylor to the company at the time this transaction took place, but the proof shows that since these lands were so conveyed the company has been engaged in mining coal from them, and hence it will be presumed that these lands were deemed valuable for coal deposits supposed or known to be beneath them, and it is well-known how prone men, and especially sanguine and hopeful men, are to over-value mining and coal lands, what high estimates are placed upon their future possibilities of value and development and the fair inference from the testimony in this case is that this Coal Company, with its valuable charter, was satisfied to accept these lands and did so accept them in full payment for its stock, in the expectation and belief that the full value of the stock was represented by these lands, and the fact that this expectation may have proved fallacious, although there is no proof to that effect in the record, furnishes no ground for the present claim of the complainants. They certainly have no higher equity than the company would have had against Taylor, and the company would have had no such equity, except for a fraudulent over-valuation, and that only upon a rescission of the contract, by a prompt re-conveyance of the land, so as to place Taylor in as good a position as he was when the transaction begun."

Assuming that the property transferred to the Columbia Straw Paper Company should be valued on the basis

of the results of the business carried on by it, then the appellants cannot prevail in their contention, since the sequel indicated that the stock was of no value whatever.

The company paid interest on its bonds for one year only. It was hopelessly insolvent at the time when the foreclosure action was instituted, although the record discloses no indebtedness save that represented by the bonds, or so much as was secured by them. The bonds represented $1,000,000 in money furnished by the bondholders, all of which had been paid to the mill owners and the company. If speculation on the subject of value is the basis of appellant's argument, or may be indulged in for their benefit, it may well be said that there is no evidence that the actual value of the property which the mill owners transferred to Stein was greater than the cash which they received for it. That being represented by bonds, the stock stood for nothing, and especially where the interests of creditors are not involved it cannot be treated as though it represented its par value, nor can it be made the basis for the predication of any liability on the part of its holders for the company.

It is certain that at the time of the issuance of the stock, it had no market value. None, so far as appears, has ever been sold. The appellants have given no evidence of its real value. It was either validly issued to Stein as claimed by the respondents, or it had no value, if the appellant's contention be pressed to its logical conclusion.

Such being the case, even as against creditors no liability would arise out of the transaction of which peti-

tioners complain, and *a fortiori* no liability would exist as to the corporation or those representing it.

Fogg v. *Blair*, 139 U. S., 118.

Clark v. *Bever*, 139 U. S., 96.

Handley v. *Stutz*, 139 U. S., 417.

Union Loan & Trust Co. v. *Road Co.*, 51 Fed. Rep., 840.

Smith v. *Ferris Co.* (Cal.), 51 Pac. Rep., 710.

The foregoing cases were proceedings by or on behalf of creditors of the insolvent corporation. The rules enunciated by the courts in those cases apply in much greater force where, as here, the proceedings are by the corporation or by a stockholder on its behalf.

The laws of New Jersey, under which this corporation was organized, provided that any manufacturing corporation might purchase any property necessary for its business, and issue stock to the amount of the value thereof in payment therefor, and that the stock so issued should be full-paid stock, not liable to assessment. (Sec. 55, Corporation Laws of New Jersey.)

VII.

As the defendant corporation could not assert the defense of set-off, or assert a stock liability, the appellants cannot do so on behalf of the company.

When the corporation has contracted to deliver and has delivered its full-paid and non-assessable stock in payment for properties, while it may enforce the contract as made, and in a proper case, rescind it, it cannot, as has been shown, make a new contract for the parties, and

cannot compel the stockholder to pay for his stock. Leaving creditors out of consideration, an action by the company against the stockholder is an act purely for the benefit of stockholders, and when, for the reasons given above, the company cannot enforce a different contract from what the parties made, the stockholder cannot enforce such different contract for the same stockholders, or for a part thereof. A stockholder may assert, on behalf of the corporation, a defense which the corporation might have asserted, but which it has improperly refused or neglected to assert, but he cannot maintain on behalf of the company a defense which the company could not maintain.

VIII.

Appellants as stockholders cannot maintain a proceeding to enforce payment by bondholders of their alleged unpaid stock for a fraudulent overvaluation since they participated and acquiesced in the transaction.

Stockholders in a corporation who participate or acquiesce in an issue of paid-up stock upon payment of less than its par value, or who have knowledge of the fact and acquiesce therein, cannot afterwards complain of the transaction, either in their own behalf or in behalf of the corporation. They are bound by estoppel or acquiescence.

1 Cook on Stockholders, Sec. 39.

Not only the participating and acquiescing stockholders, but also their transferees are bound by the participation or acquiescence. The transferee cannot claim to have greater rights than his transferer as regard a general remedy involving the whole transaction. He cannot bring suit on behalf of the

corporation against the party or parties participating in the issue inasmuch as his own title is tainted with the same fraud.

1 Cook on Stockholders, Sec. 40.

In *re Gold Co.*, L. R., 11 Ch. Div., 701–12, the court said:

"It could not be a fraud upon or a wrong to the existing stockholders because every one of them was a party of the transaction."

Hinckley v. *Pfister*, 53 N. W. Rep.,

The court says:

"As both the corporation and Hinckley participated in the unlawful issue of the bonds they occupy no position to ask the intervention of a court of equity, for they, neither of them, can make out a title to relief except by showing a plain and positive violation of the statute. They are in equal wrong with Pfister, to whom the bonds were issued."

1 Pomeroy's Eq. Juris., 461, 462.

By attempting to attack the good faith and honesty of purpose of the directors of the defendant company in issuing the stock, and questioning the validity of the issue, petitioners involve themselves in the accusation made, they having been active participants in the transaction, and the recipients of the benefits resulting from such stock issue. It is a most astonishing bit of brazenness that at the very moment when they attack the validity of the stock issue, they have safely stowed away in their pockets a large block of such stock which they persist in holding.

Callaman v. *Windsor*, 78 Iowa, 193.

Lewis v. *N. Y. etc. Iron Co.*, N. Y. Law Journal, April 30, 1890.

Clark v. *American Coal Co.*, 86 Iowa, 436.

A purchaser of stock that has voted for an issue of watered bonds and stock is estopped from complaining, even though the issue was prohibited by the constitution of the state.

Wood v. *Correy R. R. Co.*, 44 Fed. R., 146.

So in the matter of Syracuse etc. R. R. Co., 91 N. Y., 4, Judge RAPALLO said:

> "If it were true that an illegal election must be complained of and set aside in order to enable the court to compel an election, the complaint should be entertained only when made by some aggrieved party, who is not himself the author of the wrong complained of."

In *Barr* v. *N. Y., L. E. & W. R. R. Co.*, 125 N. Y., 373, Judge GRAY said:

> "We may concede that the contract was voidable as a scheme concocted by the directors for sharing in the profits of construction. But the difficulty is that all the members of the corporation were assenting to it. There was, therefore, in fact, no fraud practiced upon the company. Practically the promoters of the corporation in this way placed a valuation upon the corporate properties and franchises, which the contribution and expenditure of their money created; and the fact that they were created for an expenditure less than the par value of the aggregate issues of stock and bonds does not affect the question at all. The stock so issued constitutes the only stock of the company, and is represented in the holdings of the plaintiffs and of this respondent. Their shares stand on precisely the same footing as to validity. The plaintiffs were parties to the construction contract, and the original holders of the respondent's shares received their stock in the same way and for the same considerations."

See also

Kent v. *Quicksilver Mining Co.*, 78 N. Y., 159-188.

Parsons v. *Hayes*, 14 Abb., N. C., 419.

Langdon v. *Fogg*, 18 Fed. Rep., 8.

In *Thompson* v. *Bemis Water Co.*, 127 Mass., 595, a judgment creditor of a corporation, unable to enforce his judgment by execution, filed a bill in equity in behalf of himself and all other creditors against the corporation and certain stockholders to enforce the personal liability of the latter on the ground that the capital of the corporation had been withdrawn and paid to the stockholders. He had at the time contracted for eight shares of the stock, paid for them in part, and voted as owner at meetings of the stockholders. At one of these meetings a considerable portion of the cash assets of the company was withdrawn from its capital and divided among the stockholders in the proportion of the old amount of stock held by them respectively. The plaintiff was present and voted in favor of the division.

Upon these facts it was held that the bill could not be maintained, since he could not make the act which he had favored and voted for a ground for charging the stockholders with personal liability for a debt due from the corporation to himself.

Chief Justice GRAY, speaking of the complainant's attitude, pointedly said:

> "He now seeks to make the very act which he as a stockholder took part in bringing about, and in reaping the benefit of, the ground for charging Warren and other stockholders with personal liability upon a bill in equity for a debt due from the corporation to himself. This cannot be permitted."

The principle of this case was applied in *Bank of Fort Madison* v. *Alden*, 129 U. S., 372, where it was cited with approval by Mr. Justice Field. There, a stockholder in an insolvent corporation, who had paid his stock subscription in full by a transfer of a tract of land was sought to be charged by one of the creditors of the corporation who had knowledge of and assented to the transaction at the time when it took place. It was held that such creditor was debarred from seeking relief in equity.

In *McGeorge* v. *Big Stone Gap Imp. Co.*, 57 Fed. Rep., 262, an action was brought by a stockholder of an improvement company for equitable relief on allegations that the assets of the corporation had been wasted, misappropriated and diverted to purposes wholly foreign to that for which the company was organized. The complainant was a stockholder of the corporation; he had voted for and approved of an appropriation of the corporate funds for this purpose.

It was held, that having participated in the transaction, he would not be permitted to attack it.

In *Washburn* v. *National Wall Paper Co.*, 81 Fed. Rep., 21, Judge Lacombe, speaking for the U. S. Circuit Court of Appeals for the second circuit, said:

> "Since good-will is property, and since in some cases it is valuable property, it would follow that in some way or other it must be practically possible to determine what that value is. Whether the particular method employed in the case at bar to ascertain such value is or is not a proper one, and whether the appraisement made when these several wall paper concerns were bought up by the defendant company was accurate, we are under no obligation to inquire upon the complainant's request. The method of valuation was one which they fully ap-

proved, and which was applied in fixing the value of their own property, as the result of which they received $1,831,800 in common stock of the defendant. They certainly, participating in the transaction and reaping its benefits, are in no position now to claim that the good-will bought by the defendant company with common stock was overvalued."

See, also,

Ten Eyck v. *Pontiac Co.* (Mich.), 72 N. W. Rep., 362.

Nicrosi v. *Calera Co.* (Ala.), 22 So. Rep., 147.

Woolfolk v. *January*, 131 Mo., 620.

Drake v. *N. Y. Suburban Water Co.*, 26 App. Div. (N. Y.), 499.

In the recent case of *Unckles* v. *Colgate*, 148 N. Y., 529, a holder of "certificates of trust" issued by the National Lead Trust, sought to bring an action to provide for the winding up of the affairs of the trust, for an accounting by its trustees, and a distribution through receivers of the proceeds of the property. The trust was alleged to be contrary to public policy.

It was held that the action could not be maintained, since the plaintiff, while standing upon his right as a certificate holder, was in the attitude of one not disaffirming the illegal contract, but of seeking its enforcement. Even assuming that he had a *locus penitentiæ*, he could only avail himself of it by withdrawing from the illegal scheme, repudiating all share in it, and returning whatever he had received therefrom,

It was further held that the agreement for the formation of the trust was to be treated as one executed when the proposed combination of business concerns affected by it had been perfected, and no act remained to be

done by the parties to the agreement but to put it into operation; the agreement having passed out of the executory stage could not be repudiated.

The language of Judge GRAY is extremely pertinent, and is applicable to the position assumed by the complainants in the present case, *who pretend that they are seeking to protect their rights as stockholders which owe their inception to the agreement which they have now attacked*, who have made no effort to repudiate the transaction by offering to return the stock which they received from the corporation.

> "The plaintiff here voluntarily became a participant in a scheme which he alleges to have been illegal, by acquiring the trust certificates subsequently to the formation of the trust. * * * What interest has the plaintiff other than that which his certificate suggests, namely, a proportionate interest as a beneficiary in the trust scheme? He could not well lay claim to the ownership of stocks or property surrendered to the trustees. He acquired certificates which represented the amount of his interest in the trust and which contained a stipulation binding him as their holder to all the terms of the trust agreement. He thus voluntarily made himself a party to a scheme under an executed agreement, which he alleges to have been illegal, and how can he now say that it is one which he can disaffirm and as to which, upon the plea of disaffirming, he can ask a court of equity to intervene and to compel in his favor an accounting and distribution by the trustees. * * *
>
> "It is very clear that the plaintiff is seeking the aid of the court to enforce certain rights which he deems to have accrued to him by virtue of or as the result of the trust agreement, and although his contention is that his rights are independent of, and unaffected by the illegality of the agreement, he is claiming exactly what the contract was intended to give. As was observed in *Peck* v. *Burr* (10 N. Y.,

at page 298), 'the plaintiff seeks to have the full benefit of the contract, though in a form of action a little different.' I do not see how the court could grant to plaintiff the relief he demands without recognizing the agreement, and I may use the words of Sir WILLIAM GRANT, Master of the Rolls, in *Thomson* v. *Thomson* (7 Ves., 470), who in discussing the right of a plaintiff to recover from a fund, observed: 'You have no claim to this money except through the medium of an illegal agreement, which, according to the determinations, you cannot support. * * * Here you cannot stir a step but through that illegal agreement, and it is impossible for the court to enforce it.' I must, therefore, dismiss the bill."

In like manner in *National Wall Paper Co.* v. *Hobbs*, 90 Hun., 288, where the validity of the vendor's agreements was tested by one of the complainants' confederates, and its legality in all respects sustained, Mr. Justice VAN BRUNT used this significant language:

"In view of the fact that the defendant retained the price which was paid for his corrupt and wicked agreement" (here the court merely assumes the defendant's position *arguendo*) "it is difficult to see how he can claim that he should be absolved from its obligations, or *how he can claim, being a party to the instrument, and having received that which he considered an adequate consideration for the restraint which was put upon his volition, that such restraint should be removed, and he be permitted to enjoy the fruits of what he claims to be his unlawful agreement. We do not think that the defendant is in a position to attack this contract, certainly not with its fruits in his pocket.*"

In *Parsons* v. *Hayes*, 14 Abb. N. C., 419, the directors of a corporation issued paid up certificates for the entire capital stock of the company, amounting nominally to $2,000,000, in payment for a mine which was

known to be worth less than $150,000. The vendor of the property thereupon, in pursuance of a previous arrangement, turned over to the directors a portion of the stock which had been issued to him, which they sold to innocent purchasers. The plaintiff, such a purchaser, brought suit in the form of a stockholder's action against the corporation and directors who issued the stock, seeking to make the individual defendants account for the difference between the nominal value of the stock issued, and the real value of the property received in payment. It was, however, held that the defendants were not liable, inasmuch as the acts of the defendants were performed with the consent, and at the instance of the holders of the entire capital stock. Neither the corporation, nor its stockholders suing on its behalf, could complain.

In *Morawetz on Private Corporations* (2nd Ed.), Sec. 290, the author, speaking of this decision, says:

> "This decision was clearly right. The absurdity of the plaintiff's claim became apparent when it is considered that there was no corporation in existence until the issue of the shares which constituted the alleged injury to the corporation had taken place. It is true the statute declared that the signers of the certificate of incorporation should be a corporation, but this at most constituted them a *quasi* corporation to be succeeded by the real corporation consisting of the stockholders when the stock was issued. The vendor of the property in truth took back what he gave. He placed the property in the corporate name, and at the same time practically became the corporation by becoming its sole stockholder. Evidently, therefore, no person was injured by that transaction. If subsequent transferees of shares were deceived by false representations, their claim should have been for the damages caused to themselves individually through the

false representations, and not for an infringement of the collective or corporate rights of all the shareholders."

To the same effect is *Langdon* v. *Fogg*, 18 Fed. Rep., 8.

Here the entire issue of stock and bonds of the company became the property of Stein, in consideration of the conveyance by him to the company of all its corporate property. But for said issue the petitioners would have no interest in the corporation. By asserting rights as stockholders, they must necessarily affirm the validity of the stock issued from which their relation of stockholders originated. The corporation itself would be utterly destitute of property, would have no *raison d' etre* but for the transaction which culminated in the issue of its stock and bonds to Stein. Every stockholder of the corporation assented to the issue, and derives his interest in the corporation from that transaction. The corporation still holds the property in consideration of which the stock and bonds were issued. It received the money of the purchasers of the bonds, and disbursed it to the appellants and other mill owners. Neither the corporation or any of the stockholders have ever disaffirmed the transaction or attempted to make an effectual rescission. How, then, can either the corporation or appellants, who have intervened, not in their individual but in their representative capacity assume to defend for the corporation, attack the very transaction from which corporate life and the existence of stockholders derived their origin, and while affirming the validity of the stock issue, so as to afford to petitioners a standing in court, deny to it all efficacy so far as the bondholders are concerned, whose money the petitioners have received.

Surely the language of Judge FINCH in *Seymour* v. *Spring Forest Cemetery Assn.*, 144 N. Y., 341, may, with but slight change in phraseology, be applied here:

> "That kind of plunder which holds on to the property and pleads the doctrine of *ultra vires* against the obligation to pay for it, has no recognition or support in the laws of this state."

The defense of equitable set-off for stock liability, asserted by appellants, admits a liability on the bonds, and seeks to discharge it by the offset.

> "The subject of a set-off is a cross-debt or claim on which a separate action might be sustained, due to the party defendant from the party plaintiff."
>
> Waterman on Set-off, page 3.

> "A set-off is not a defense. When a set-off is made, mutual claims to an equal amount on each each side become, under the statute, a satisfaction of each other. They operate as a payment of each other. Where the claim of a plaintiff is wholly paid by a set-off, his action is at an end, and he may be liable to costs, but his claim has not been defeated by a defense, but has been paid by the extinguishment of claims against him in equal amount."
>
> Waterman on Set-off, page 9.

A recoupment differs from set-off in that it must arise out of some transaction on which suit is brought, and that it is used only to the extent of the extinguishment of a plaintiff's claim, but it is none the less a *counterclaim*.

Waterman on Set-off, pages 469, 470.

To establish this counterclaim the defendant to that extent becomes the plaintiff, and has the burden of making affirmative proof of his claim. He cannot, under the authorities, affirmatively show a stock liability arising out of a fraudulent overvaluation, since he participated in the transaction.

The prime cost of the mills to Stein was $2,788,000. Of this amount $697,000 was a *bonus* to the mill vendors above the agreed selling price of the mills. This reduces the actual sum for which the owners agreed to sell their mills to $2,091,000. This sum was payable one-third in cash, one-third in preferred, and one-third in common stock. Whether and how far the upset price of the mills was advanced beyond their actual value, in consideration of such terms of payment does not appear.

The mill owners in their options contracted with Stein that he should acquire an indefinite number of mills. They purposely made no provision as to the number that should be purchased. This was left to the discretion of the promoters, aided by the mill owners, and to be controlled by circumstances. Evidently, if an existing mill could not be bought except for an amount far beyond its value, it was not intended it should be acquired. If a mill would be of no value to the new organization because of its location, construction, machinery, or for any other reason, its purchase was not contemplated. What would occur in these regards could not be foreseen.

Several of Stein's associates were mill vendors. They and Stein were in frequent consultation with the others. (Rec., 449, 455.) It must be presumed the purchase of but thirty-nine mills, was acceptable to all under the circumstances which existed. It can not be assumed by the vendors that Stein was obligated to purchase more mills than he did, since in the written instrument which defined his and their rights and duties, no such requirement is made. It can not be so assumed on the ground that prior to the contract, there had been conversations on the subject, since none are shown, and if there were any they were merged in the written contract; nor can

an obligation to that effect be predicated upon any contract, agreement or statement made thereafter by Stein since there is no evidence thereof. The conclusion, therefore, must be that Stein, in acquiring thirty-nine mills, fulfilled all his obligations in regard thereto, to the mill owners.

The mill vendors further required that this company be capitalized with a stock issue of four million dollars, and a bonded debt of one million dollars, secured by mortgage on the properties acquired. That is, the company, holding properties as appellants claim, of the value of not to exceed $2,091,000, and since there was to be a bonded debt of one million dollars, having a net capital of but $1,091,000, was to issue four million dollars of stock, or four times the net capital, thus making the stock worth on the theory of appellants, twenty-five cents on the dollar.

What was the object of the mill vendors in requiring such alleged excessive stock issue? What did they intend should become of it? Evidently that it should be divided among all parties in interest. First they contracted that they themselves should receive $1,287,000, in part payment for their mills. Next, that they should receive $700,000 as a *bonus* without any payment therefor. In that way, each mill vendor got one-third of the value of his property in cash, and received in addition stock to the full value of his plant. In this way, appellant Diem got his stock as a *bonus*. So did appellants Hooker and Richardson, other mill vendors. So did the Grahams, whose stock Dickerman, the remaining appellant, holds.

The vendors knew that to acquire the mills, create and

finance the corporation would require an immense amount of labor on Stein's part, the employment of many associates and skilled agents, and the incurring of very large expenses; that all, and more than all the money which Stein could get for his stock must be paid to the vendors and to the company for working capital. Stein and his agents could get nothing for their services and disbursements until, and unless the company was successfully floated, the bonds and stock sold, and they knew that stock must be used freely for the multifarious purposes, preliminary to the organization of the company.

They knew also that $1,000,000 of bonds upon property which was worth at cost prices not over $2,000,000, could not be sold at par, nor without a heavy bonus of stock.

They intended that Stein should offer a *bonus* of stock with the bonds sufficient to induce bondholders to buy them at par. This is fully shown by the fact that the vendors were all offered bonds with that *bonus;* that so far as objecting to such sale they bought a large amount of bonds; that one of appellants bought four $1,000 bonds on these terms. In this way they expected that $600,000 of stock would be disposed of as a *bonus.*

In taking $700,000 of stock as a direct *bonus* to themselves, (the same being $33\frac{1}{3}$ per cent. above the par value they fixed on the mills), in acquiescing and participating in the gift of $600,000 of stock to the bondholders, this being 60 per cent. of the par value of the bonds, and by making no provision as to the amount of compensation to Stein and his associates, whom they must have intended should be compensated, they practically agreed and are estopped to deny that Stein was entitled in addition to his reasonable compensation, to share by the

way of *bonus* in the stock of the company from 33⅓ to 60 per cent. of the amount of his services and disbursements, this being the percentage of division to the other parties in interest; they intended that Stein and his assistants should receive for promotion services and expenses all the stock and bonds which were not disposed of by the option contracts. There is no evidence that the allowance was in any way excessive or unreasonable.

That they acquiesced in the division as made, is made certain from the fact that they were parties to the option contracts, and received their share of the *bonus;* that many of them were pecuniarily interested as bondholders in the company, and in all its acts affecting the value of their bonds, and especially that they were stockholders to the amount of $1,887,000 under their contracts, the same being nearly one-half the stock. In addition, they bought from $100,000 to $200,000 of the bonds (Rec., 443), and received therewith from $60,000 to $120,000 of stock, making their aggregate stockholding from $1,947,000 to $2,007,000. Having these interests in the company for the three years during which the company continued in business, and being entitled as stockholders to be heard in stockholders' meetings, neither any of the appellants or any other mill vendor in stock holders' meeting or elsewhere, ever opened his mouth to object to the transaction between Stein and the company, or to criticise it in the slightest particular during the existence of the company, nor has any *mill vendor* in fact done so in this case or at any time since.

The court will not investigate nor determine whether appellants or the promoters or the bondholders made the best bargain in the division of the surplus stock. Appellants got what they demanded. The others got what they

could. All received some, and if there is any guilt, all are equally guilty. To compel the bondholders to pay for the stock they so received, or, as the same thing, to set off the amount against the bonds, would be inequitable. The effect would be to assess one guilty person for the benefit of others equally guilty. It would enhance the value of the stock of a guilty party asserting the guilty transaction.

IX.

When all the bonds and stock of a company are conveyed for property which the company acquires all *THEN* stockholders assenting, neither the company nor any then or subsequent stockholder can complain.

When the conveyance was made by Stein to the company for its stock and bonds, but eighteen shares of stock had been issued. The holders of this stock paid par for it. They were all directors of the company. Their assent to the transaction as well as that of the company is evidenced by the agreement they made with Stein. Appellants and the other mill owners became stockholders soon after the organization of the company. They acquired their stock from Stein. They knew that it was, to the extent of $700,000, stock for which they had paid no consideration, and that Stein was getting it in the same way from the company, or received it from the company by adding it to the selling price to the company. They knew that Stein was giving to the purchasers of bonds $600,000 in stock, and was obtaining it under the same circumstances. If there was any overvaluation, their own acts made overvaluation necessary. They participated in the overvaluation, and hold the fruits of it.

They are attacking the remaining parties who followed in their footsteps. For three years, and until the failure of the company, they acquiesced in the contract under which they obtained their own stock and other stockholders obtained theirs, and no one of them by his testimony or affidavit has furnished any evidence that he did not fully understand and approve of such arrangement.

In *Scoville* v. *Thayer*, 103 U. S., 143, the court said:

> "The stock held by the defendant was evidenced by certificates of full-paid shares. It is conceded to have been a contract between him and the company that he should never be called upon to pay any further amounts upon it. The same contract was made with all the other shareholders, and the fact was known to all. As between them and the company it was a perfectly valid agreement. It was not forbidden by the charter nor by any law of public policy, and as between the company and the stockholders was just as binding as if it had been expressly authorized by the charter. If the company, for the purpose of increasing its business, had called upon the stockholders to pay up that part of their stock which had been satisfied by discount according to their contract, they could have successfully resisted such demand. No suit could have been maintained by the company to collect the unpaid stock for such a purpose. The shares were issued as full-paid on a fair understanding, and they bound the company. * * * Considered in the view of a court of equity the contract between the company and its stockholders was this, namely, that the stockholders should pay, say, for example, $20 per share on their stock, and no more, unless it became necessary to pay more to satisfy creditors of the company, and when the necessity arose and the amount required was ascertained, then to make such additional payment on the stock as the satisfaction of the claims of creditors required."

Higgins v. *Lansingh*, 154 Ill., 333.

In this case it was held that the issue of stock by the corporation for much more than the value of land which constitutes its only capital, *when there are no other stockholders or creditors of the company* to complain, cannot be held to be a fraud on the company itself. The court says:

> "But counsel insist that the corporation was defrauded, that Benson, Blaney and Sherman, being a majority of the board of managers, voted the issue of the capital stock and scrip to themselves without paying the company anything for it and in fraud of the rights of the company, and that such stock and scrip are therefore void. The evidence shows that no deception was practiced on any one; there was no concealment nor pretense of any payment to the company otherwise than by what was called Benson's equity in the land; no pretense that the company had any other capital.
>
> No one was beguiled into becoming subscriber to the capital stock, or a creditor of the company on the supposition that Benson paid anything more than he actually did pay. What was done was done openly, and so far as the evidence discloses, honestly. The company obtained from Benson all the capital it had, and gave no more in return than it received. Had there been at the time other stockholders who had paid for their stock, or creditors who had been injured by the transaction and not assenting thereto, then as to them, counsel's argument would be unanswerable. But in passing on this branch of the case, we must regard the company as a mere instrument by which the plan of Benson and his creditors was carried into effect. If instead of forming a corporation they had conveyed this land to a trustee, clothing him and his successors with power similar to that contained in the charter, as fully as it could be done without an act of the sovereign power of the state, to devote this land to cemetery purposes, it would have been no fraud on the trustee to obtain from him certificates showing that all beneficial interests in the proceeds of the sale of

burial lots belonged to Benson and his creditors. Before the conveyance to the company whatever value the lands had then or prospectively, belonged to Benson and his creditors, and they could have preserved their right to its value by any lawful means, and could have retained the beneficial interest in the proceeds of the sales of burial lots in devoting the lands to cemetery uses. We cannot see why they could not, without any fraud on the company where there was no one else to be injured, take from the company certificates of interest or stock (for the term is immaterial) evidencing their interest in the corporation, or in the proceeds of sales of what had then become corporate property. It is the substance ofthe transaction that a court of equity must regard, and not the mere form in which the parties have clothed it.

The several counsel for appellants have argued at great length, and cited hundreds of authorities in their endeavor to show that the stock and conditional scrip was fraudulently issued to Benson, and that therefore a court of equity will not grant any relief to the holders of it, who have no higher equities than Benson himself. It is not, and as we understand the evidence, it cannot be correctly maintained that there was any fraudulent intent or purpose, any deception, concealment, misrepresentation or imposition by Benson. But the contention is that in so obtaining the stock and scrip as shown by the evidence, it amounted to a fraud upon the company itself, there being no one else to be defrauded. We are of the opinion that it was lawful for Benson, with the consent of his creditors, to devote these lands to the purpose of a cemetery through the instrumentality of this corporation, and the lands being the only capital of the company, and there being then no other stockholders or creditors of the company to complain, to take and receive from the company certificates representing all of the capital stock, even though their face value was far beyond the value of the lands. It was a mere change from private to corporate ownership of the lands."

Coffin v. *Ramsdell*, 110 Ind., 417.

Here it was said:

> "Patent rights and mining manufacturing property which are embarked in enterprises are frequently valued by their owners and others at a prospective value which may or may not be realized, depending upon future contingencies. If the owners who put such valuation thereon acted in good faith and yet suffered disappointment, we can see no reason why they should suffer further unless they have been guilty of fraud or concealment which has resulted in damage to others."

Foster v. *Seymour*, 23 Fed. Rep., 65.

Here the trustees of a corporation had delivered to themselves the stock in payment of their mining property. Mr. Justice WALLACE said:

> "The corporation lost nothing by the transaction disclosed by the bill, except the paper which was created and called capital stock. None of this stock was diverted. The scrip was not capital stock. The capital stock of a corporation is the money or property which is put into a corporate fund by those who subscribe to the stock and thereby agree to become members of the corporate body. Unless it represents capital contributed or agreed to be paid in, it has no value. The property it received in exchange for the scrip had some value, certainly as much as the scrip had. There was no fraud upon the corporation. At the time the scrip was exchanged for the mining property the trustees were all there was of the corporation. There were no stockholders unless *they* were the stockholders. What was done was done by the corporation. By the exchange the corporation got the mining property and gave it back again to those from whom it got it, divided into 100,000 shares of a nominal value of $100 each."

Stewart v. *St. L., Ft. S. & W. R. R. Co.*, 41 Fed. Rep., 736.

Here Tiernan and others had purchased an old road-bed and incorporated the defendant railroad company, and were on its first board of directors. They then sold the road-bed to the company for $200,000 of the notes of the company and $3,600,000 of its capital stock, which purchase was afterwards ratified by the stockholders, The court said:

> "At the time of the sale there were no stockholders and the $3,600,000 of stock issued under the said purchase was all that had been subscribed or issued, and the only assets of the company were its charter and the road-bed. It appears from the evidence that the road-bed originally cost about $2,000. It had no marketable value only as it could be used for the purpose for which it was made. It also appears from the evidence that the stock and notes of the company at the time they were issued, had no present marketable value. The value of the property sold as well as the consideration paid (stock and notes) depended very largely upon the success of the enterprise. There is no doubt but the directors, while directors of the company, used their influence to consummate this sale from themselves as individuals to the company, and it is altogether probable that they had that object in view when they bought the road-bed, but the question still remains, are they guilty of fraud, deception or any other breach of good faith in their fiduciary relations as directors? * * * It does not appear in this case that there was any deception or fraud practiced by the parties. The property was open to inspection, and the approximate cost of constructing it was easily obtainable. Its value to the company for the purpose desired was not difficult to ascertain. * * * Now who was defrauded? All parties—directors and stockholders—assented to it and surely subsequent purchasers of the stock from the corporation itself can not now object to it."
>
> *St. L., Ft. S. & W. R. R. Co.* v. *Tiernan*, 37 Kan., 606.

In this case a suit was brought on one of the promissory notes given for the road-bed in *Stewart* v. *Railroad Company*, *supra*. In reviewing the same transaction the Supreme Court of Kansas said:

> "It has been decided time and time again that the owner of a mine, an oil-well or a valuable patent can organize a corporate company to develop mineral or oil, or to manufacture the patented article and take a very large amount of stock in payment of his mine, oil-well or patent, and trust to the value given the stock by the success of the corporation for payment of his labor and discovery. In this class of cases there is a mere transfer of the status of the mine, oil-well or patent. It ceases to be personal property and becomes corporate property, and each individual interest, as well as that of the owner, discoverer or patentee, is represented by shares of stock. It is now decided in this case that the owners of a graded railroad bed can sell the same to a railroad company whose officers and directors are composed of the same identical persons who own the road-bed and issue the stock of the Railroad Company in payment therefor at a time when those who sell the road-bed and own and control the railroad corporation are the absolute owners of all the stock issued by the Railroad Company, and when the terms of sale and the issue of stock are matters of record on the books of the Railroad Company, and when this transaction occurs months before any other or additional stock is issued by the company; that parties owning an old railroad grade, with culverts and some bridges erected thereon, and who organized, control, manage and own the Railroad Company whose stock at the time of the issue has no market, but only a nominal value, can transfer the railroad grade to the Railroad Company, and issue the stock of the company in payment therefor, they and they alone at that time being the only persons interested in the road-bed and in the Railroad Company."

The above cases, *Memphis R. R. Co.* v. *Dow*, and *Bank of Ft. Madison* v. *Alden*, *supra*, establish that it is the rule of this court that where there has been no actual fraud, even as against *creditors* claiming an over-valuation, their claims would be denied.

As the transaction between Stein and the company, all its then stockholders assenting, was as between those parties a valid transaction, subsequent stockholders de-riving their stock through Stein cannot question it.

It does not appear that petitioners have any griev-ance against Stein. If they have, it does not concern this suit.

If the cases cited for appellants were in conflict with the foregoing decisions which have received the sanction of this court, they would have no weight here, but they proceed upon a wholly different state of facts from those involved in this case, and are irrelevant. Among those cases is that of

Morrow v. *Nashville Co.*, 87 Tenn., 262.

There complainant filed a bill to be relieved from a stock subscription to the amount of $10,000 which he had executed to the company, on the ground that the company had refused to carry out its agreement with him concerning his bonds. The bill prayed that his notes which he had executed to the company in part payment for its capital stock be canceled, and that he have a de-cree for $1,000 cash which he had paid on his subscrip-tion. His bill alleged that by agreement between the company and the stockholders the issue of bonds was to be $350,000 and the same amount of stock; that each subscriber was to have stock and bonds given him by the company, each for the same amount as he subscribed.

The company changed its plans and decided to issue bonds for only $100,000 and to sell them on the market. All assented except complainant. The company refused to deliver him the stock and bonds. There had been a *subscription* by him to the capital stock and an independent contract from the company to him to give him bonds and stock. The contract was wholly unexecuted on the part of the company. The court says:

> "It follows from all that we have said that the stipulation concerning the issuance of bonds to subscribers for capital stock was not a *condition precedent* to liability upon the subscription. It was nothing more than an independent stipulation for the breach of which the remedy would be in damages. The failure of the company to carry out its collateral agreement does not defeat the liability upon the subscription. This independent contract was however illegal and void, whether regarded as a condition precedent or subsequent, and for such breach no action would lie. It follows, inasmuch as complainant is liable in equity and at law upon his subscription, that there is no equity whatever in his bill, and the decree dismissing it with costs is affirmed."

In that case the court virtually recognizes the distinction for which we contend, and for that very reason held that it would not enforce an executory contract which would have the effect of jeopardizing the interests of creditors. Had the contract been executed, it is clear that it would have been sustained as between the corporation and its stockholder. But being executory, and clearly hostile to the manifest rights of creditors and likewise *ultra vires*, equity left the parties where it found them.

The other cases cited by appellants relate to suits by creditors and have no application here. It is apparent that those cases proceed on different lines and involve different equities from those in the case before the court.

Brewster v. *Hatch*, 122 N. Y., 349, was a wholly different case from this. There concealment and fraud was practiced by the promoters, who afterwards became stockholders, upon their associates.

The court merely held that the promoters of a corporation who held themselves out as trustees to the plaintiffs when they solicited them to purchase stock, by concealing from such purchasers the fact that a majority of the stock was to be retained by such trustees for their own benefit and without any consideration whatsoever, were liable in *damages* to such purchasers in their individual and not in any representative capacity, on the theory of fraud and deceit.

X.

No fraud, concealment or deceit was practiced on appellants, or any vendor.

While the option contracts were being procured, and thereafter and until the company was organized, there were frequent consultations between Stein and his associates and the mill vendors. At these times the progress in obtaining options, the cost of properties, the bonus to the mill vendors and to bondholders, were discussed. Stein's proposition to the company was made a number of days prior to the agreement with the company and the latter modified the proposition. The terms of the option contracts, the number and cost of the mills, the *bonus* offered, the agreement with the company, were open to all. Nothing was secreted.

The mill owners by their option contracts practically determined the arrangement as it was accepted. They fixed the entire amount of stock which should be issued,

and each vendor fixed the amount he should receive. All required that there should be issued to them over and above the selling price of the mill an amount of stock equal to one-third such selling price. The contracts, while they imposed great labor and expense upon the promotors, were silent as to their compensation and reimbursement. That they intended they should be compensated in some way, admits of no doubt, and it is equally evident that it was intended that such compensation should proceed from the corporation to be formed. They must also have contemplated that unless the promotors should be ultimately successful in acquiring the properties, conveying them to the company and floating the company, their labor and expense would be wholly lost, and that under such conditions in case of ultimate success their compensation should be generous and unstinted. They also realized that the promotors must pay their assistants, their agents and attorneys and discharge their expense on like terms, contingent upon success, and to such ends they must use the stock of the company in an amount greatly in excess of an amount which would have been adequate had the promotors been able to deal upon an absolute cash basis. They also understood that to raise money for the payment of their own mills and for other necessary purposes, a sale of the bonds would be necessary. Their experience as business men taught them that bonds of a new industrial corporation could be floated at par only by the offer of some extra inducement in the form of stock, or other way. That they anticipated this is also exhibited by the uncontroverted evidence that they knew that $600 of the company's stock was offered and given with each bond sold; that a number of vendors, including one of appellants,

purchased bonds and received such amount of stock therewith; that they made no objection at the time to such action and never did until after the company's failure, and that no one of the millmen has in this case, either as a witness or by affidavit, denied that the sale of the bonds with *bonus* of stock was done with his full knowledge and approbation.

There were frequent meetings between the promoters and the mill owners. A majority of the Board of Directors had been such mill owners. By their silence as to the amount of compensation to the promoters and by stipulating for their own bonus of stock, they practically gave and intended to give to the promotors *carte blanche* as to the amount of stock they should receive for their own remuneration. This is substantiated by facts showing that while the proposition from Stein to the company was made December 10, 1892, immediately after the organization of the company, while the agreement between Stein and the company was executed December 15, 1892, and while the transaction was the all-important act of the company and was spread upon its records, while the millmen, including appellants, soon afterwards became through Stein stockholders and were affected with constructive notice, and had actual notice of the transaction, and while the company continued in business more than three years, during all of which time the millmen, including appellants, continued to be stockholders, no one of them, either at a stockholders' meeting, or elsewhere, objected to or in any way questioned the good faith of the transaction, and no one of them has appeared in this case to deny by his testimony or his affidavit that the transaction was had with his full knowledge and approval.

Even Sherwood did not venture to state that the transaction by which the company contracted with Stein and conveyed its stock and bonds to him, was not fully known to the millmen and to every one of them. He does state that he understood that seventy mills were to be taken by the company, but he does not state that any one told him that there should be, or that he received any assurance to that effect. He also testified that the millmen did not know that less than seventy mills were taken into the company, but on cross-examination it appeared that he was not testifying as to his knowledge, but merely his belief. (Rec., 373, *et seq.*)

It is submitted that Sherwood's testimony is not entitled to respect. He stated that he promoted, induced and brought about this proceeding by appellants in order to compel the persons who were directors of the company to pay him $25,000 which they did not owe him. He showed in his cross-examination that he did not hesitate to swear absolutely to that of which he had no knowledge. That he is using appellants as a tool to accomplish his private purpose appears from the fact that no one of appellants appeared as a witness, swore to any affidavit, or even signed a pleading or other document of record, but that all was done by Sherwood. Appellants merely permitted Sherwood to use their names. Not they, but he, is the real party who is prosecuting this appeal.

The burden of proving fraud or deceit practiced upon the mill owners was upon appellants. They proved none whatsoever.

The company was organized in the way in which appellants and other mill vendors intended it should be organized.

The plan authorized by them was that Stein should acquire the properties and convey them to the company. The company was to furnish Stein with the means of paying the vendors. The parties of the second part to the option contracts to whose rights and obligations Stein succeeded, were to pay the vendors the cash and the stock called for by the option contracts. Payments could not be made to vendors until the company was organized, had issued the stock and delivered it to Stein. Until such time the vendors were not to become stockholders; Stein was to organize the company. To organize a corporation means to provide its organic elements, viz.: incorporators, a charter, stockholders, directors and officers, so that it can do business.

The incorporators were Philo D. Beard, William C. Heppenheimer and William C. Taylor, each of whom subscribed for four shares of stock. These incorporators elected a temporary board of directors, which made the agreement with Stein, and the transfers of the stock and bonds to him, which enabled him to pay cash and transfer stock to the mill vendors as they had required he should. This temporary board, through this contract, carried out the plan which had been stipulated for by the appellants themselves and the other mill vendors in their contracts.

If there was no fraudulent over-valuation of the property, as we have attempted to show, then all the stock was fully paid and appellants had no just grounds for complaint.

If it should be considered that there was such fraudulent over-valuation as would enable *creditors* to maintain an action against the stockholders, to enforce a

stock liability, the company cannot, nor can a stockholder on behalf of the company, sustain such action, because the contract which Stein entered into was to pay for stock with the properties and in no other way, and there is no room for an implied contract where there is an express one. Therefore, neither Stein nor his transferees can be held liable for payment of the stock.

And if the value of what Stein conveyed was less than the par value of the stock it equaled it in actual value. Stein conveyed the property and got certificates of stock, the stock was worth what the property it represented was worth—no more and no less. Appellants and all parties agreed to the transaction. They participated and acquiesced in it and are estopped to attack it.

But even if we were to assume that the individual stockholders may have been the victim of deceit (which is not the fact), yet that circumstance would afford them no standing in this action. Separate causes of action would exist in favor of individual stockholders against the persons who may have been responsible in a legal sense for such deceit. Such cause of action would give rise to a common law action as to which right of trial by jury would exist and would not be cognizable in a suit in equity. Moreover, the corporation would have no concern with such a cause of action. It would not enure to its benefit. It would not affect the trustee for the bondholders or the body of bondholders or of stockholders. It would have no relevance to an action brought to foreclose a mortgage executed by the corporation simply because the fraud or deceit related to the stock of such corporation or may have been practiced by one or more of the bondholders secured by the mortgage in process of foreclosure.

What concern is it to A, B and C, bondholders secured by the mortgage to the corporation, or to D, E and F, stockholders of the corporation, that G, another bondholder, or H, the original holder of all the bonds, may have been guilty of deceiving I, J and K, who happen likewise to be stockholders of the corporation whose property is being foreclosed?

Such fraud or deceit might likewise warrant the rescission of the sale of property made in consideration of stock fraudulently issued, but the party rescinding would be obliged to act promptly, and to return the entire consideration received. The petitioners did not offer to return their stock or the cash which they received. Neither does the corporation. Yet they ask that the bondholders, who have received no benefit from the stock issued to them, should forfeit their bonds, for which they paid $1,000,000, the whole of which was received by the corporation and distributed among the petitioners and other mill owners, who seek to retain whatever they have received in cash, and now wish likewise to retain the entire property freed from the mortgage lien without paying one dollar to the bondholders.

XI.

In no view of the case can any relief be granted against the stockholders of the Columbia Straw Paper Company in this action brought in a forum other than that of New Jersey, the laws of which regulate this corporation.

In effect, the appellants attempt in this action to enforce a stockholders' liability against the bondholders.

This they do by seeking to extinguish the liability of the corporation to the bondholders by an enforcement of the liability of such bondholders as happen to be stockholders, as stockholders.

It requires no argument to sustain the proposition that there is no common law liability on the part of such stockholders to the corporation or to a creditor, even though the stock which these bondholders may have held was not full paid stock. Their liability, if any, must depend upon the statutes under which the corporation was organized and which created a remedy as against stockholders whose shares were not fully paid.

An examination of the statutes of New Jersey indicates that no cause of action exists against such stockholders in favor of the corporation or in favor of any other stockholder. The only liability which is created is that specified in the following provisions of the New Jersey corporation laws:

> SEC. 5. "Where the whole capital of a corporation shall not have been paid in and the capital paid shall be insufficient to satisfy the claims of its creditors, each stockholder shall be bound to pay on each share held by him, the sum necessary to complete the amount of such share as fixed by the charter of the company, or such proportion of that sum as shall be required to satisfy the debts of the company."
>
> SEC. 27. "The directors of every such company may, from time to time, assess upon each share of general stock such sums of money as two-thirds of the stockholders in interest shall direct, not exceeding, in the whole. the amount at which each share shall be originally limited under the third article of the eleventh section of this act; and such sums so assessed shall be paid to the treasurer at such times and by such installments as the directors shall direct, said directors having given thirty

days' notice of the time and place of such payment in a newspaper circulating in the county where such company is established."

SEC. 28. "If the owner or owners of any such share or shares shall neglect to pay any sum or sums duly assessed thereon for the space of thirty days after the time appointed for the payment thereof, the treasurer of the company may sell, at public auction, such number of the shares of such delinquent owner or owners as will pay all assessments then due from him or them, with interest, and all necessary incidental charges; provided, two-thirds of the stockholders in interest shall so direct."

SEC. 93. "When any of the officers or directors of any company, or stockholders thereof, shall be liable, by the provisions of this act, to pay the debts of such company, or any part thereof, any person to whom they shall be so liable may have an action on the case against any one or more of the said officers, directors or stockholders; and the declaration in such action shall state the claim against the company, and the ground on which the plaintiff expects to charge the defendants personally."

SEC. 94. "When any of the said officers, directors or stockholders are liable, as mentioned in this act, for the debts of any such company, or any part thereof, the person to whom they are so liable may, instead of the other proceedings mentioned in this act, have his remedy against the said officers, directors or stockholders by a bill in chancery."

SEC. 96. "No sale or other satisfaction shall be had of the property of any director or stockholder for any debt of the corporation of which he is such director or stockholder till judgment shall have been obtained therefor against such corporation, and execution thereon returned unsatisfied, but any suit brought against any such director or stockholder for such debt shall stay after execution levied or other proceedings to acquire a lien until such return shall have been made."

Under these statutory provisions, it has been held that

a creditor must exhaust his remedy by judgment and execution and return *nulla bona* before he can resort to the liability of stockholders; that such suit can only be prosecuted by a creditor suing in behalf of all the creditors of the corporation, and that the corporation is a neces- party to the suit, and that all of the assets of the corporation must be brought into the suit and put in the course of administration.

Wetherbee v. *Baker*, 8 Stew. Eq. (N. J.), 501.
Bickley v. *Schlag*, 8 Dick. Ch. (N. J.), 533.

Numerous other acthorities might be cietd to the same purpose.

It clearly follows from these statutory provisions, as they have been construed by the New Jersey Court of Chancery, that a special remedy is created, under the laws of that state, for the enforcement of the statutory liability imposed upon stockholders. This remedy, from the nature of things, is exclusive, and hence it follows, from numerous well-considered cases, that the remedy, being exclusive, can only be pursued in the forum of the state which creates it, and there is a uniform line of authority to the effect that the courts of other states will not apply special statutory remedies designed to be pursued in the courts of the sister states, particularly where it is sought to enforce a stockholder's liability.

Erickson v. *Nesmith*, 4 Allen, 233.
New Haven Horse Nail Co. v. *Linden Springs Co.*, 142 Mass., 349.
Bank v. *Rindge* , 154 Mass., 203.
Marshall v. *Sherman*, 148 N. Y., 9.
Barnes v. *Wheaton*, 80 Hun., 8.
Lowry v. *Inman*, 46 N. Y., 119.

Young v. *Farwell*, 139 Ill., 326.
Fowler v. *Lamson*, 146 Ill., 472.
Patterson v. *Lynde*, 112 Ill., 196.
Id., 106 U. S., 519.
May v. *Black*, 77 Wis., 101.
Nimick v. *Iron Works Co.*, 25 W. Va., 184.

In *Erickson* v. *Nesmith*, *supra*, the court said:

> "It is urged, on the part of the plaintiffs, that great practical evil may result from thus refusing to charge a party here who is an actual stockholder of a corporation in New Hampshire, but who resides without its limits, To this it may be replied, that it would be a much more serious evil to hold that the whole matter of winding up the concerns of a bankrupt corporation of New Hampshire, ascertaining who are its creditors, who its stockholders, what is the amount of its assets, and how are the same to be distributed, should be transferred to the jurisdiction of Massachusetts, by reason of the residence here of a single member of such corporation. There seems to be no practicable mode of dealing with such corporation and its members, when seeking to charge the latter upon their statute liability, but to proceed in the manner prescribed by the statute creating such liability, and in the local jurisdiction where the corporation was established and carries on its business, and by whose local statutes alone the liability exists."

Here the petitioners are seeking, by indirection, to enforce, as against the stockholders, who were likewise bondholders, and who constitute but a small portion of the stockholders, a stockholders' liability for the purpose of extinguishing the bonded indebtedness of the corporation. Under the authorities this could not be done in New Jersey under the statutes as they have been construed by the Court of Chancery. How then can a

remedy, created under the laws of New Jersey, be enforced in another tribunal which would be unavailing? And how could the remedy which is here resorted to, and which must be based upon the laws of New Jersey, be enforced in another tribunal? Especially must this be true where but a portion of the creditors, and a small proportion of the stockholders, are parties to the suit.

XII.

The court did not err in striking appellants' cross-bill from the files.

It is well settled that in a bill to foreclose a trust deed like that in this case stockholders are not necessary parties, that they can become parties only by leave of court, and that such leave will be granted only when some fraudulent conduct on the part of the bondholders, trustees or other parties is alleged to have occurred which could affect the rights of complainant trustees to foreclosure proceedings.

Thomas v. *Brownville R. R.*, 109 U. S., 526.

The Circuit Court upon application by appellants permitted them, upon their petition, to become defendants, and to answer and file a cross-bill upon the hypothesis that their answer might disclose a state of facts which would preclude complainants from enforcing the foreclosure of the trust deed, or which would allow it to be enforced only to a limited extent, and that the cross-bill would be germane to the original bill, would seek such relief as could be granted in the suit, would not set up merely matters of defense and would be in compliance with the Rules of Practice in Equity.

Appellants were merely an insignificant part of the stockholders and were not creditors. The theory of their answer was that all the bondholders had acquired stock of the company without payment therefor, or that they were assignees of such bonds with a notice of all equities, that they were indebted to the company for such stock, and that the court should in that action ascertain such indebtedness and set off or recoup the same against the bonds. It was apparent that this was matter in *defense* of the action which could be fully availed of, if at all, under the answer. Under their answer appellants had the full benefit of that defense. Their defense failed, but not for want of a cross-bill.

The cross bill set up the same facts and claims as did the answer. It was the answer *verbatim* with merely such changes as differentiate in form an answer and a bill. It prayed that an account be taken as to the bonds and stock and that stock liability be applied in discharge of the bonds. As the Court of Appeals said:

> "It alleged the fraudulent overvaluation of property by the company and by directors and stockholders; that the contract under which the bonds were issued was fraudulent and void, and that the bonds and mortgage were void; all of which was matter of defense and had been set up in the answer. * * * If two answers setting up the same matter had been put in, no one would question but what one of them should be struck out, and the labeling of one a cross-bill does not change the rule."

A cross-bill setting up no defense except what could be set up by answer, will be dismissed.

Am. Co. v. *Marquans*, 62 Fed. R., 660.

Where the right claimed by a defendant consists simply in excluding the plaintiff from the right asserted by the latter, of course there is no occasion for a cross-bill.

1 Foster's Fed. Pr., Sec. 171.

A cross-bill never should be brought where parties can obtain in the original suit the relief sought for by the cross-bill.

2 Daniels Ch. Pr., p. 1,551.

But appellants claim that the object of the cross-bill was not merely to establish a defense to the bonds, but to obtrude into this foreclosure suit a proceeding on behalf of the defendant corporation to determine whether there was a fraudulent over-valuation; to ascertain the extent of such over-valuation, if any; to establish the extent of the liability of the few stockholders who were made defendants; to apply so much of said liability as was necessary to discharge the same against their respective bond indebtedness, and to obtain a decree in favor of the company for any remainder by way of affirmative relief.

There were abundant reasons why such bill could not be maintained.

1. The bill was, as appellants show, filed by stockholders of a corporation under the 94th Equity Rule. It does not comply with the rule, in that it does not contain allegations that complainants were shareholders at the time of the transactions of which they complain, to wit: the delivery of the bonds and stock to Stein by the company in payment for the property purchased, or that their share had devolved upon them since by operation of law. It affirmatively appears that they were not stockholders at the time of said transactions, and that the stock came to them subsequently by contract and not by operation of law, and that they acquired it with constructive and probably actual notice of all the transactions complained of. This was an incurable defect.

Next, the bill does not allege that the suit (the cross-bill) was not a collusive one, to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance.

2. It affirmatively appeared that only a small number of stockholders were made parties to the cross-bill. It would be most inequitable to allow a minority of the stockholders to be selected as defendants, and to decree that they pay to the company an unpaid balance due on their stock for the benefit of the remainder stockholders whose stock was equally unpaid. A proceeding against stockholders could be maintained only where all stockholders as well as creditors were made parties, and where all the affairs of the company could be liquidated. No attempt was made at any time to amend the bill in this respect.

3. It was shown that in the chancery proceeding in New Jersey (where the company was created) a receiver of the company had been appointed at the instance of creditors to collect and distribute all the assets of the company (Rec., 568), and due recognition of the rules of comity required the court below to refrain from attempting to supersede the rights of such receiver, appointed in the proper proceeding, where the rights and liabilities of all parties could be adjusted. The petition on which a receiver was appointed in New Jersey was filed April 3, 1895 (Rec., 563); the receiver was appointed May 6, 1895 (Rec., 568); the cross-bill was filed May 18, 1895. (Rec., 99.)

4. The cross-bill, so far as it seeks affirmative relief beyond purposes of defense, was not germane to the original bill. The original bill was for the foreclosure of a mortgage. Under it mortgagees in possession sought to

subject the property to the payment of the bonds secured by the mortgage. The subject-matter of this suit was this subjection of the property to the payment of the bonds. The subject-matter of the cross-bill (beyond what was matter of defense) was the enforcement of a stock liability of certain stockholders to the original complainant. Such relief could only be had by an independent proceeding. No amendment to the cross-bill could change this situation.

Lund v. *Skanes Enskilda Bank*, 96 Ill., 181.

In this case a foreign bank filed a bill against the assignee and creditors of an insolvent banking firm in Illinois to establish a debt due from the latter to the former and to obtain dividends out of the partnership property. It was held that a cross-bill by the resident creditors of the insolvent bank against a foreign bank, alleging that the latter was a member of the partnership or a partner in the firm, and asking a decree against the foreign bank for an amount sufficient to pay the debts of the defendant creditors, and those represented by them remaining unpaid after the assets in the hands of the assignee were exhausted, was not germane to the original bill and was properly dismissed on demurrer. The court said:

> "The subject-matter of the original bill was the proper distribution of the proceeds arising from the partnership property in the hands of the assignee, and that bill related alone to the disposition of that property. The cross-bill in the relief sought has no relation whatever to the disposition of this fund in the hands of the assignee, but relates to a matter entirely independent and different."

It would be unprecedented to allow a bill to enforce a stock liability of creditors to be attached to a bill to foreclose a mortgage.

A cross-bill, being an auxiliary bill merely, must be a bill touching matters in question in the original bill. If its purpose is different from that of the original bill, it is not a cross-bill, even though the matters presented in it have a connection with the same general subject.

Cross v. *DeValle*, 1 Wall., 1.

5. There was no showing that the bondholders, or any of them, were insolvent, or that full relief could not be had against them by any party entitled to any in the proceeding in New Jersey on behalf of creditors, or in any other original proceeding.

6. The complainants in the cross-bill were *in pari delicto* with defendants in the transactions complained of, or they succeeded to the ownership of stock, with knowledge of all facts, from those who were participants in said transactions.

The trial court and the Court of Appeals were of the opinion and held that the evidence in the case did not sustain the defense asserted in appellants' *answer*. If their conclusions were well founded, *a fortiori* appellants' cross-bill could not be maintained.

It is apparent that this cross-bill prosecuted by stockholders who were unable to comply with the 94th Rule of Equity, who were *in pari delicto* with the defendants, who after full opportunity were unable to produce testimony to support their allegations, who had failed to make necessary parties defendants, who showed no ground for equitable relief, who were attempting to prosecute a cross-bill which could not be maintained because it was not germane to the original bill, could by no amendments make a cross-bill which under the evidence could be maintained.

The time limited to defendants and to cross-complainants to close their proofs finally terminated January 3, 1896. (Rec., 338.) The cross-bill was not struck from the files until January 21, 1896. (Rec., 256.) All testimony which was or could be introduced to sustain the cross-bill was then before the court, and is in the record. If it does not sustain the answer, it could not support the cross-bill, and the latter must certainly have been dismissed on final hearing, or relief under it denied for want of equity, had it not been disposed of at an earlier date. Appellants have then lost no right, and are in no worse position than they would have been had the order striking the cross-bill from the files not been entered. As the court has before it all the evidence which could be used to support the cross-bill, and as it is insufficient to sustain either the answer or the cross-bill, substantial justice has been done in the case, and the error complained of by appellants that the cross-bill was stricken from the files has caused them no injury, it being immaterial in result to them whether the cross-bill was struck from the files, dismissed on demurrer or on the final hearing. It is submitted the cause could not be reversed for an erroneous ruling when it is apparent from the whole record that appellants have sustained no injury. Appellants' grievance is not that they did not obtain the remedy they sought, but that it was properly denied them in an erroneous manner. Error without prejudice, it is submitted, is not sufficient ground for a reversal of the decree.

Deery v. *Gray*, 5 Wallace, 795.
Gregg v. *Moss*, 14 Wall., 564.
Allis v. *Ins. Co.*, 97 U. S., 144.
Gammon v. *Pratt*, 99 U. S., 619.
Mining Co. v. *Taylor*, 100 U. S., 34.
Hornbuckle v. *Stafford*, 111 U. S., 389.

But we contend that there was no error in striking appellants' cross-bill from the files.

The motion to strike the cross-bill from the files rested on the ground that the *interlocutory orders of a court of chancery are always under the control of the court;* that if on inspection of the cross-bill filed under leave of court, it appeared that the matter set forth was not matter to justify a cross-bill, it was as fully within the power of the court to strike the cross-bill from the files as it was to give leave to file it.

Forbes v. *Memphis R. R.*, 2 Woods, 325.

The above case was heard on motion to vacate an order allowing certain parties to intervene as defendants, and to file answer and cross-bill, and the court says:

> "The intervenors having, as the court thought, presented a *prima facie* case, orders were made in accordance with their request. The complainant moved to vacate the order, and the question was raised whether the applicants should be allowed to intervene. * * * It is questionable whether in any case where a suit is properly instituted against a corporation a stockholder of that corporation can, even on a suggestion of fraud on the part of its officers, come in by way of intervention as a party to that suit, and seek to defeat and control the proceedings. An original bill would rather seem to be the proper mode of proceeding, and it is in the discretion of the court whether or not to permit a stockholder to become a party defendant in any case where he is not made such by the bill, and as it is held to be an extreme remedy to be admitted by the court with hesitation and caution, I think I ought not to have allowed it in this case and ought now to withdraw the order for such allowance. The orders for leave to intervene and file answers and cross-bills will be vacated."

The above case is not inconsistent with that of *Betts* v. *Lewis*, 19 Howard, 72, cited for appellants.

The latter was an original bill. The complainant was in court *by right of law and not by permission of court.* In such case, the court cannot dismiss except on motion or on final hearing. Before the pleadings were made up upon motion the court dismissed the bill for want of equity. This was held to be erroneous, the court suggesting that any defects in the bill might be cured by amendment. The rule in relation to cross-bills *filed by leave of court* is different. There the court may withdraw its permission. When in such case the court ascertains that the cross-bill filed is not such as was entitled to be filed under its order, and where it is of such a nature as to be wholly wrong and incapable of amendment so as to sustain it, it is in the power of the court to revoke its permission and dismiss the bill, and that was what was done by the Circuit Court in this case. The cases cited for appellants are not in point. It has never been held that the interlocutory orders of a court were not under its control.

XIII.

There was no necessity for a production of the bonds before the master.

The foreclosure suit was by mortgagees *in possession.* Under a mortgage given to secure 1,000 negotiable bonds, the trustees, although they did not own any part of the mortgage debt, were the proper parties complainant.

2 Jones on Mortgages, Sec. 1,383.

Jones on Corporate Bonds and Mortgages, § 386.

This is a departure from the rule which requires the real parties in interest to be the parties complainant.

The Columbia Straw Paper Company, which alone executed the mortgage, was originally the only defendant. Appellants, minority stockholders, became defendants by leave of court, on their own application, in order to set up defenses which as they claimed, the company neglected or refused to assert. The complainant trustees were not the owners of the bonds or any of them, but were mortgagees in possession and had power and the duty under the trust deed (Rec., 41; Art. VII) to enforce the lien of the mortgage by foreclosure and sale.

In ordinary actions upon negotiable paper the plaintiff is the original payee or is a transferee of the instrument, and one of the material questions at issue is whether he is the owner and therefore entitled to maintain the action. Such are the cases cited for appellants.

Where a mortgage has been made to trustees to secure a large number of bonds, as in the case of railroad mortgages and those of large industrial and other corporations, in an action of foreclosure by the trustees, such question does not arise. The ordinary rule that the real parties in interest must be the parties complainant is departed from, as well as the rule that the complainant must produce the bonds.

It is not pretended that the trustees own any of the bonds. Their right of action did not depend upon their possession or ownership of them. It was the agreement of all parties that they should enforce the mortgage without regard to ownership. It is sufficient that they prove in regard thereto that the bonds were valid bonds; that they were issued and are still outstanding and unpaid in

the hands of some one, it matters not whom. That and that alone was the issue for them to maintain in that regard. When that was established the indebtedness of the mortgagor was judicially established. The right to a decree of sale was not affected by the question who were the holders of the bonds at the time of such decree or sale.

The original bill in this case averred (Rec., 5) that

> "All of the one thousand bonds of $1,000 each, with the coupons attached, were duly issued, negotiated and sold, and are now outstanding and valid obligations of the defendant, Columbia Straw Paper Company, and the same, with the coupons annexed thereto, have come into the possession of and are now held by a large number of persons who have become the owners thereof,"

and that all the bonds were in the form set forth in the mortgage. This was distinctly admitted by the answer of the defendant company (Rec., 70), as follows:

> "Defendant admits that it executed and issued one thousand bonds of $1,000 each, and alleged in said bill of complaint, of the tenor and effect and containing the provisions substantially as set forth in said bill, and that said bonds were certified by the said Northern Trust Company, complainant, as trustee, and that the same have been negotiated and sold and are now valid outstanding obligations of said defendant company, as in said bill set forth."

What the creditor complainants aver on this [illegible], and the defendant company admitted, was established. No further proof was necessary. Appellants, simply minority stockholders, could not question the situation as thus established unless they affirmatively showed the admission to be untrue and fraudulent. If the defendant company is satisfied with the decree in this regard, the

minority stockholders can have no voice, as no fraud is perpetrated upon the company.

Appellants did not attempt to show that the admission of the company was untrue. On the contrary, by their pleadings they admitted, and by their testimony proved that it was true. The petition of appellants (Rec., 77) showed that all the bonds were *issued and paid for at par* by the purchasers. The *answer* of *appellants* (Rec., 89) admitted that they were *issued* and are *outstanding*, but denied their validity for the reasons assigned. The testimony of Mr. Heurtley for complainants showed (Rec., 219) that the one thousand bonds described in the mortgage were certified and issued by the defendant company; that the company had not paid or discharged any of them; that the interest coupons due June 1, 1894, December 1, 1894, and June 1, 1895, had not been paid. The testimony on behalf of *appellants* (Rec., 280) showed in detail that the bonds were issued and to whom they were issued, and that they were still owned by the parties named. The master found and certified (Rec., 266) that all the issue of said one thousand bonds was negotiated and sold and is now outstanding, and a valid obligation of the defendant, Columbia Straw Paper Company, and that they were due and unpaid. The decree (Rec., 528) so found, and ordered a sale unless payment was made (Rec., 531) within a specified time. There was no personal decree against the defendants for costs, or against the defendant company for any deficiency, such matters being reserved for future consideration by the court (Rec., 544).

It is then established that the one thousand bonds, the contents of which were proved, had been duly issued and were outstanding. The only thing that can possibly be

regarded as in dispute is their validity. This question of their validity could not be determined or affected by the production and inspection of the bonds. The court already knows what they were. The attack on their validity must rest upon evidence outside the bonds themselves. If the court concludes from the evidence that they were valid, their production before sale was unnecessary. If invalid, their production at any time would be futile.

The validity of the bonds we have discussed elsewhere. The only question here is whether in foreclosure proceedings in the case of mortgages given to secure a large number of bonds, a production of the bonds before a decree of sale is necessary.

No useful purpose would be subserved by requiring trustees to produce the bonds before the master in order to entitle themselves to a decree of sale. On the contrary, to so require would be a denial of justice to most of the bondholders as well as to the trustees, who must look to the proceeds of a sale for their compensation and reimbursement.

As the Court of Appeals said in its decision:

> " In these cases where bonds issued by railroads or other large corporations on a large scale, and held in trust by trustees, but really owned by persons in many parts of the civilized world, it has not been the practice, nor will it be practicable to require the bonds to be produced before the court or master before a decree *nisi* is entered. The practice has uniformly been, to enter a decree of sale without the production of the bonds. Of course they cannot be paid or share in the proceeds of sale until brought into court for payment and cancellation. In many cases years elapse after a decree is entered before all the bonds are brought in, the money lying in the

registry of the court awaiting their presentation for payment, and in some cases, all the bonds are never produced or paid. If the rule required all the bonds to be produced before the court or master, before a decree for sale could be made, it would, in many cases, be a practical denial of justice. No such practice has ever obtained to our knowledge, and the sale is made for the benefit of all properly concerned. The decree is not final as to the persons or debts entitled to share in the proceeds. When the time for distribution arrives, any creditor may challenge the title of the claimant of any bond presented."

Toler v. East Tennessee R. R., 67 Fed. Rep., 168.

In this case a bondholder owning a small number of bonds, filed a bill for foreclosure against the railway company on behalf of all bondholders who might join as complainants. Others, claiming to own more than $2,000,000 of the $6,000,000 issue, joined as complainants. The trust company was made a defendant and filed a cross-bill, also praying a foreclosure. Issues were joined, proofs made, and the case was ready for a decree and the complainants and cross-complainants both moved for a decree of foreclosure.

The court said:

"The point has been made that it has not been alleged or shown that complainants own any of the defaulted coupons. Complainants claim to own or represent more than $2,000,000 par value of bonds. They allege that the coupons maturing August 1, 1893, February 1, 1894, and August 1, 1894, aggregating $450,000 'are due and wholly unpaid, together with interest thereon to your orator and other holders of said bonds.' This is a sufficient allegation of ownership. The cross-bill of the trustee seeks the same relief in behalf of all unpaid interest. A decree finding unpaid interest is justified by the al-

legations of either bill. It is not necessary that each claimant of a bond or of unpaid interest should at this stage of the foreclosure case, identify himself as the owner of bonds or unpaid coupons. It is not necessary that the bonds with coupons should be produced before a *nisi* foreclosure decree. It is only necessary that it should, at this stage of the cause, appear that there has been a default, and the amount of that default. This showing has been made. Should a decree with sale be made absolute, the holders of bonds can then be required to produce their bonds and coupons before a master, and all questions connected with the amount due each, and of ownership, can then be determined. *Guaranty Trust and Safe Deposit Co.* v. *Green Cove Springs & M. R. Co.*, 139 U. S., 150, 151; 11 Sup. Ct., 512. Such a decree is not to be regarded as final as to the debts entitled to share in the distribution, for any other creditor may challenge the debt when the claims are produced in the master's office for ascertainment and classification. The decree for a foreclosure only, establishes that there has been a default in the payment of the three last installments of interest. It does not establish that that interest is due to any particular person. * * *

"A decree *nisi* will be drawn as here indicated, requiring the mortgagors to pay into the registry of the court the amount of the defaulted interest, with interest from maturity of each installment. Such payment will be made on or before the expiration of 90 days from date of decree. In default of such payment, the shares held in trust will be sold under foreclosure of the mortgage, principal and interest. * * * In case a sale is made, it must be a final foreclosure of the whole property, the purchase money taking the place of the trust shares. The distribution will be in satisfaction, *pro rata*, of all the bonds, principal and interest."

In that case one-third the bonds were owned by complainant bondholders and two-thirds were represented by

the trust company. The court held their production was not necessary prior to a decree of sale.

In the above case, as well as in this case, the decree was a decree *nisi*. A sale was to be made unless within a fixed time the defendant paid the amount of the decree. Such decree was not only a *nisi* decree, but it was a final decree, from which appeal or writ of error could be taken. It was not final as to the parties entitled to share in the distribution of the proceeds.

The court in this case denied a right of set-off against the bondholders arising out of their alleged stock liability. If it committed no error therein, the distribution will be freed from such question of set-off. If the court erred therein, then the decree was bad altogether. The production of the bonds could not have aided the court in the determination of that question.

XIV.

There was no collusion or fraud in connection with the Flannagan judgment and the issuance of the execution thereon and the proceedings by reason thereof.

"Collusion" is defined as follows:

> "Secret agreement for an *unlawful* purpose; *fraudulent* co-operation; a secret agreement between persons to *defraud* or to obtain an *unlawful* object through legal proceedings."
>
> Standard Dictionary.

> "An agreement between persons to *defraud* another of his *rights* by the forms of law, or to obtain an object forbidden by law."
>
> Anderson's Dictionary of Law.

"An agreement between two or more persons to *defraud* a person of his *rights* by the forms of law, or to obtain an object *forbidden by law*."

Bouvier's Law Dictionary.

Flanagan was a bondholder, residing in New York. He sent six coupons owned by him to Mr. Wolf for collection. The latter, not being willing to act in the matter, gave them to Mr. Leffingwell, telling him that Flanagan had sent them to him for collection, but that he did not desire to act. The latter, without further instruction, acting for Flanagan, immediately put them into judgment. The president of the defendant company afforded the plaintiff all facilities for a speedy trial. It was had and execution was issued, and it not being immediately paid, the trustee at once took possession.

The defendant company owed the debts sued for. It had repeatedly defaulted in its interest. All its property was subject to the mortgage given to secure its bonds. It was insolvent and unable to continue in business. The evidence leaves this in no possible doubt. It had no defense to the action. No duty rested upon Flanagan to refrain from entering judgment, and none upon the defendant company which should have caused it to throw any obstacle in the way of the judgment, or which should have induced it to attempt to defer judgment until the mortgaged assets should be dissipated and its mortgagees involved in litigation with other parties as to their rights. Nothing was done which was forbidden by law or equity. A debtor corporation, by the individual, may at any time dispose of all or any part of its property in payment of its just debts. It may anticipate the time of payment.

It is settled that an insolvent corporation, like a pri-

vate individual, independently of any positive law to the contrary, may in good faith turn out a part or the whole of its property in payment of its debts.

Gottlieb v. *Miller*, 154 Ill., 52.
Ill. Steel Co. v. *O'Donnell*, 156 Ill., 630.
Fogg v. *Blair*, 133 U. S., 534.

Here no debt was created. Years before, and on the organization of the corporation, it had executed this mortgage to secure this issue of bonds. The execution of the mortgage was approved by all parties in interest. It was stipulated for by the mill vendors in their option contracts. It was agreed to by every director, officer and stockholder in the company. The holder of every bond had paid therefor $1,000 in cash. The company received every dollar of this cash. The complaint of appellants is not that the bonds are invalid, but that a defense in the way of set-off exists against the bonds growing out of stock transactions. It does not appear that any director of the corporation held any of its bonds in January, 1895. It is immaterial whether they did or not, as the securities named in the mortgage had been pledged to the trustees years before to secure a valid debt. When the company became insolvent and had no assets with which to conduct busines, the civil law authorized, and the moral law required the corporation to surrender the mortgaged property to the mortgagees in order that they might protect their own interests.

It was lawful for the company to turn over the mortgaged property to the mortgagees in payment of its debt, without any action on the part of Flanagan, or any one, and without any judgment against it, and without any action by the trustees or bondholders. When the com-

pany did indirectly what it might have done directly, when it permitted a judgment against it to which it had no defense, the effect of which was to allow possession by the mortgagees, its conduct was not only legal, but in a high degree equitable, and minority stockholders, since there was no fraud, can not complain.

Concede all that appellants claim, that Flanagan intended by his judgment and execution to bring about foreclosure and possession by the trustees; that the company, being aware of his intention, facilitated his purpose, and that the trustees had foreknowledge of his intent and of the action of the company, there was no collusion in a legal sense.

The situation was not that of a corporation able to conduct business whose career was unnecessarily arrested by grasping bondholders. It was an insolvent corporation, destitute of resources, hopelessly in debt, whose continuance in business would, under the circumstances, have been a fraud not only on the bondholders but upon all with whom it should have dealings.

There was no artifice, fraud, trickery or stratagem on the part of Flanagan or the defendant company. His purpose to obtain a judgment so that the mortgagees might take possession was open and honest, and so was that of the corporation.

If the failure to institute a defense to a valid cause of action and the predication of legal rights based on a judgment thus obtained constitute collusion, creditors of a corporation cannot safely act on a judgment taken by default by confession or on offer. A corporation would be bound to contest every claim presented to it. Any attempt to facilitate its lawful creditors in securing their

rights would be subject to attack by any stockholder who may seek to further his own private ends by i posing obstacles in the way of its creditors.

That the course pursued in this case is not subject to criticism has been adjudged, although authorities seem unnecessary to sustain so manifest a proposition.

Farmers Loan & Trust Co v. *Green Bay Co.*, 6 Fed. Rep., 100, 110.

County of Leavenworth v. *Chicago, etc.*, 25 Fed. Rep., 229.

Toler v. *East Tennessee, etc., Ry. Co.*, 67 Fed. Rep., 168, 177.

But it is urged by appellants that the entry of the Flanagan judgment, and the issuance of execution thereon was not a sufficient ground for the action of the trustees in declaring the mortgage indebtedness due, and this because the judgment obtained on the coupons could not be levied on the mortgaged property, and there was no other.

The trust deed provided (Rec., 31) that if a judgment was rendered, and an execution sued out against any of the property of the company, and the company did not forthwith remove such execution, the mortgage security should at the option of the trustees, be enforcible. Exactly that happened. When the mortgage was made all parties were presumably acquainted with the law relating to the levying of executions on mortgaged property under a judgment in favor of a coupon-holder, and with that knowledge they entered into the mortgage. That there was no property belonging to the company other than the mortgaged property was a cogent reason for the action of the trustees in declaring the mortgage indebtedness due.

It is claimed that "forthwith" in the trust deed meant some indefinite time. The company was advised of the proceedings. It knew it had no assets with which to discharge the judgment; that an appeal would merely be productive of delay and wholly unavailing: that its daily expenses, including taxes, insurance, operating expenses, etc., could only be paid, in bad faith, out of the mortgaged property, and it did not desire to take action which would do it no good and which would be inequitable against the mortgagees.

Under the circumstances "forthwith" in this instance had its ordinary meaning of "instantly" or "at once." This was the meaning the parties themselves, the company and the trustees, put upon it. Such construction by them is conclusive.

It is claimed that the entry of the judgment was procured by the trustees or their attorneys. This charge is unfounded. The testimony does disclose the insolvency of the company; its inability to pay its accrued interest, or any part thereof; the absence of all assets on its part except its mortgaged property; that it had exhausted its resources and could not continue in business; that the entry of a judgment had been determined on by its creditor; that the company was aware of this, and of the fact that the object was to give the trustees the possession of the mortgaged property; and that the company, being fully persuaded that such action was for the interest of the company and its stockholders, as well as that of its mortgagees, recognized the situation and facilitated the judgment and possession by the mortgagees. Where in this was there fraudulent collusion? Who was injured? Who obtained anything dishonestly? What minority stockholder was divested of his legal rights? What unlawful purpose was promoted?

XV.

Appellants contend that there was no demand against the company for the payment of interest, and no evidence of any default in such payment.

No demand was necessary.

Article 3, section IV of the mortgage (Rec., 31) provides:

> "This security shall become and be enforcible if, after any one of the following events shall have happened, the trustees shall declare the principal and interest owing upon the bonds to be immediately payable."
>
> "IV. If a judgment or order shall be made, or any effective resolution of the company be duly passed, for the winding up of the company, or if a distress, attachment, garnishment or execution be respectively levied or sued out against any of the chattels or property of either company, and such company shall not forthwith, upon such distress, attachment, garnishment or execution being levied or sued out, remove, discharge or pay such distress, attachment, garnishment or execution."

The trustees, on the ground that an execution upon a judgment had been sued out against the property of the company, and that the company had not forthwith discharged or paid the same, declared the principal and interest owing upon the bond to be immediately payable. (Rec., 220, 221, 226.)

Appellants further contend that there was no evidence of any default in the payment of interest.

Mr. Heurtley testifies (Rec., 219, 220, 221) that the interest coupons falling due June 1, 1894, December 1, 1894, and June 1, 1895, had not been paid. No objec-

tion was made to this evidence whereby complainants were required to procure better or other evidence.

The answer of the defendant company, under which appellant stockholders hold any right they have, admitted in its answer that the coupons had not been paid. Mr. Heurtley testified, not necessarily from hearsay, for he may have been an eye-witness of the facts, that they had not been paid. There is no proof tending to show that they had been paid, although such testimony, if the coupons were paid, was easily obtainable. Sufficient proof of a negative fact was thus afforded. What was distinctly alleged by the complainants, and expressly admitted by the defendant company, is established for the purposes of this case, unless the truth of the admission is attacked by affirmative evidence.

The next point for appellants is that there was no evidence that one-third of the bondholders requested in writing, the trustees to declare the principal and interest of the bonds due and payable.

In the first place, there is evidence so showing. It is found on Rec., 229, 230, 231.

Next, it is wholly immaterial whether such proof was made. When the security became enforcible, the trustees, in their discretion, with or without the request of the bondholders, were authorized to take possession. (Rec., 31.) They did take possession, and the receiver succeeded to their possession.

XVI.

The bonds were negotiable instruments.

While it is not material whether or not the bonds were negotiable, in fact they were.

By the provisions of the trust deed (Rec., 29) the bonds were to be substantially in the form indicated in the trust deed. The bill alleged that the bonds were substantially in that form, and it alleged (Rec., 3, 4) with such particularity the contents of the bonds that it was made manifest that they were in all respects in form, as well as in substance, identically the same as provided in the mortgage.

The answer of the defendant company (Rec., 70), admits this. Heurtley testified (Rec., 219), that the contents of the 1,000 bonds were as set forth in the mortgage and in the bill of complaint. The answer of appellants (Rec., 87, 88), admitted it. There is no evidence to the contrary. The bonds issued were therefore legally identical with the form provided by the mortgage.

The company, by the terms of the bonds, acknowledged itself indebted to the bearer in the sum of $1,000, and promised to pay him that sum in the manner set forth. The company promised (Rec., 26), to redeem on the first day of ember, 1893, 100 of the bonds, and on the first da of December, 1894, 105 of the bonds, and so on, each succeeding year until December 1, 1901, when it engaged to redeem the last of said bonds. Which bonds it would redeem in any particular year was not known, as this was to be determined by drawings, but its promise was to redeem all said bonds on or before December 1, 1901. The heading of the bond, "Due on

or before December 1, 1901," was a part of the bond, but the body of the bond made the same statement in a more extended form. The bonds, then, were absolutely due on or before December 1, 1901. The company reserved the right (Rec., 27), to pay them at earlier dates out of the sinking fund to be created and upon drawings to be had.

The bonds contained every element of negotiability. The form and substance of the bonds, the sum payable, the rate of interest and the time of payment and to whom and by whom payable were all distinctly declared.

But it is immaterial whether they were negotiable. No bond can share in distribution except one showing an absolute indebtedness of the company. If the bonds were not negotiable, and were in the hands of the first holder, no question could arise; if not in the hands of the first holder, the claim could be made in the name of the first holder and for the benefit of the present holder.

XVII.

This is not a case where the court can say that all parties have been guilty of fraud in obtaining from the company stock without payment therefor, and that the court will aid no one, but will leave them in the position in which it found them and where they placed themselves.

The company, through its directors, and on the requisition of the vendors of the mills, executed the mortgage involved. Its action bound the stockholders, including appellants, as well as the company. It authorized the

trustees upon a certain contingency which occurred to take possession of the property. The trustees took such possession and held actual possession when they filed their bill of foreclosure. They stated the facts, and that they held the properties in trust for the bondholders under the trust deed. They are wholly innocent parties and have in good faith expended a large amount of time, labor and expense in taking possession of the property and in attempting to execute their trust through this foreclosure proceeding. If the court declines to act it must restore the property to the trustees from whom it obtained it, and the trustees would then be the owners and in possession of the property under a trust which no court will enforce. That is, they would become absolute owners. The only way to avoid this result is either to sustain the decree of foreclosure for the benefit of the bondholders for whom the trustees claim to hold, or to take the property from the bondholders to the extent of any set-off allowed, on account of stock liability, and to the same extent give it to the company for the benefit of the vendor stockholders who are at least as guilty as the bondholders.

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